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외교학석사 학위논문

Financial Sanctions Against North Korea

Explaining the Failure of the Banco Delta Asia Sanction

북한에 대한 금융제재들:

방코델타 아시아 제재의 실패원인 알아보기

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Abstract

On September 15, 2005 the Treasury Department of the United States designated the small Macau-registered bank, Banco Delta Asia (BDA), a primary money laundering concern and warned US financial institutions to guard against their abuse by North Korea. As a consequence of this so-called ‘reputational sanction,’ the Macau government seized \$25million worth of DPRK (Democratic People’s Republic of Korea) assets while bank and institutions in over twenty countries took measures to deny financial services to the DRPK. Though the US claimed the sanction was related to international crime and not denuclearization, North Korea linked it to Six-Party Talks and blocked progress made on negotiations for an end to its nuclear program.

The sanction was initially supported both domestically and abroad and can be seen to have been a success in seriously damaging the financial capabilities of the North Korean illicit profit-making network. However, it quickly became part of a broader strategy when it was adopted by Washington hardliners as part of a policy this paper terms ‘hawk coercion’ that aimed to ‘squeeze’ the DPRK financially while ‘talking’ to them about denuclearization. This coercive diplomacy ultimately failed, and after missile launches and a nuclear test, the sanction was withdrawn.

This paper will analyze the reasons why this reputational sanction, which devalues the market commodity of trust to great financial effect, failed as a coercive tool. Bruce Jentleson’s coercive diplomacy framework will show that the policy, of which BDA sanction firstly was central, lacked proportionality, reciprocity and coercive coercion. Proportionality, as its initial objective was expanded from one of international crime to coercive denuclearization. Reciprocity, as ill timing and the ignoring of signaling meant that reciprocal trust was not attained. Coercive credibility, as a common interest and a reasonable objective was absent. In conclusion, the most fundamental reason that led to the failure of the BDA sanction will be identified. This has implications for the role of allied support and domestic political factions within coercer states in the imposition of reputational sanctions in coercive diplomacy.

Key Words : North Korea; United States; China; South Korea; BDA; Financial Sanctions; Coercive Diplomacy.

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To Mam, Dad, Michael and Nick for your constant support and for putting up
with me during a tough 3 years.

Chapter I

Introduction:

The BDA Affair

1.1 The BDA Affair

On September 15, 2005 the Treasury Department of the United States, under section 311 of the Patriot Act, designated the small Macau-registered bank, Banco Delta Asia (hereafter BDA), a ‘primary money laundering concern.’ It alleged that it was a North Korean (DPRK) front company that for more than a decade had acted as a ‘willing pawn’ in distributing counterfeit currency and smuggling counterfeit tobacco products, and was suspected of involvement in international drug trafficking.¹ Although the United States (US) had previously noted at least thirteen reported instances of the counterfeiting and distribution of US \$100 Federal Reserve notes (supernotes), earning an estimated \$15 to \$25 million per year, this was the first direct and damning action taken to prohibit US financial institutions from conducting any business with the bank.²

Following this action, in October 2005 the US blacklisted eight North Korea firms allegedly participating in the spread of weapons of mass destruction. Then, on December 13, the Treasury Department issued a further advisory warning US financial institutions to ‘guard against the abuse of their financial services by North

¹ Treasury Department, US Government, Federal Register/Vol. 70, No. 181/Tuesday, September 20, 2005/Notices at http://www.fincen.gov/statutes_regs/patriot/pdf/finding_banco.pdf, (retrieved 12/06/2011). And, Edward Alden, September 16 2005, US moves on bank accused of illicit N Korea links, *Financial Times*, at <http://www.ft.com/intl/cms/s/0/86c77690-264e-11da-a4a7-00000e2511c8.html#axzz1PRFu4Lbw> (retrieved on (12/06/2011)).

² Perl, R., & Nanto, D.K. (2007), *North Korean Counterfeiting of US Currency*, CRS Report RL33324, Congressional Research Service, Washington, DC, p13.

Korea’ and encouraged ‘financial institutions worldwide to take similar sanctions.’³ On January 26, 2005 President George Bush empathically noted that there was to be ‘no compromise’ on the BDA sanction and maintained his commitment to its imposition.⁴

The action against BDA generated an avalanche of responses both in financial and political terms. It caused such panic and a run on accounts at the bank that the government of Macau had to take over its operations and place a temporary halt on withdrawals. It shut down all North Korea-related accounts including those belonging to nine DPRK banks and twenty-three DPRK trading companies. As many as fifty North Korean accounts in BDA, which amounted to some \$25 million of North Korean assets, were frozen.⁵ These reportedly included accounts from the core organs of the North Korean regime.⁶ In the end, even the North Korean trading firm used by Pyongyang as a de facto consulate closed its operations as the Macau government placed BDA into receivership. Not only did the US action deprive major DPRK companies of an international financial base and cut into the secret personal accounts of the Pyongyang leadership but it appeared to have obstructed some legitimate North Korean trade as all North Korean accounts were simply frozen without investigation.⁷

The financial effects of the BDA action were more far-reaching than expected as the crackdown spread across the region, with Chinese, Japanese, Vietnamese, Thai,

³ Department of Treasury Financial Crimes Enforcement Network (Dec. 13th 2005) Advisory, at www.fincen.gov/advisory.pdf, (retrieved 5/6/2011).

⁴ Carol Giacomo, US rejects N. Korea Demand to end Finance Crackdown, *Reuters*, January 4, 2006, at <http://today.reuters.com/news/newsArticleSearch.aspx?storyID=19779+04Jan2006+RTRS&srch=us+crackdown>, (retrieved 21/11/2011).

⁵ Sunghan Kim, US Coercive Diplomacy toward North Korea: Current Status and Prospects, *Policy Brief*, No. 2006-8 (Seoul: Institute of Foreign Affairs and National Security, 2006), p. 4.

⁶ Mary Beth Nikitin, Mark E. Manyin, Coordinator, Emma Chanlett-Avery, Dick K. Nanto, and Larry A. Niksch, North Korea's Second Nuclear Test: Implications of U.N. Security Council Resolution 1874, Congressional Research Service Report for Congress, (July 23, 2009).

⁷ Perl, R., & Nanto, D.K. (2007), *North Korean Counterfeiting of US Currency*, p. 14.

and Singaporean banks increasing their scrutiny of North Korean account holders.⁸ Banks from other nations (such as the United Overseas Bank of Singapore and the Korea Exchange Bank of South Korea) also moved to sever contacts with North Korea, fearing that they too could face US legal action.⁹ The maintenance of their good reputation was more important to these banks than the retention of North Korean assets that amounted to a miniscule portion of the bank's total deposits.¹⁰

The BDA action came at a time when President George W. Bush, a year into his second term, was operating a complex three-track DPRK policy. The first attempted to contain horizontal proliferation using a robust PSI (Proliferation Security Initiative) regime, which was an effort to deal with the growing challenge posed by the spread of weapons of mass destruction, their delivery systems, and related materials worldwide. The second applied financial sanctions to target monetary transactions and accounts linked to proliferation financing and illicit activities. And the third engaged in negotiation and diplomacy to achieve denuclearization agreements in an approach that Victor Cha, National Security Council Director of Asian Affairs between 2004-7, coined 'Hawk Engagement.'¹¹

The primary result of this diplomatic attempt to bring North Korea to Six-Party Talks was the 9.19 Joint Agreement signed in 2005 in which the DPRK agreed to stop its nuclear program in exchange for US security assurances and a promise to promote economic links with the other Six-Party states. It was hoped that this would

⁸ Editorial, North Korea's Nuclear Test: The Fallout, *International Crisis Group*, March 22, 2007, at <http://www.crisisgroup.org/home/index.cfm?id=4502&l=1>, (retrieved on 20/10/2011).

⁹ Mary Beth Nikitin, Mark E. Manyin, Coordinator, Emma Chanlett-Avery, Dick K. Nanto, and Larry A. Niksch, North Korea's Second Nuclear Test: Implications of U.N. Security Council Resolution 1874, Congressional Research Service Report for Congress, July 23, 2009.

¹⁰ Victor D. Cha, *The Impossible State* (New York: Harper Collins Publishers, 2012), p.265.

¹¹ Victor D. Cha and David C. Kang, *Nuclear North Korea: A Debate on Engagement Strategies* (New York, Columbia University Press, 2003), pp. 91-92.

pave the way for Pyongyang to normalize relations with both the United States and Japan, and for the negotiation of a peace agreement on the Korean peninsula.¹²

However, negotiations hit a roadblock in November 2005 after the fallout from the BDA sanction as North Korea, who clearly linked it to the nuclear issue, insisted on its lifting as a precondition for returning to talks.¹³ The US did not accept the linkage and claimed, that ‘the issue of BDA was a matter of law enforcement,’ that ‘had nothing to do with North Korean nuclear issues.’¹⁴ Furthermore, they demanded the unconditional and immediate return of North Korea to the Six-Party Talks. Unwilling to remove the sanction, US-DPRK relations worsened and negotiations came to an impasse. This led to a period of instability on the peninsula and exacerbated the nuclear problem as North Korea launched missiles on July 4-5 2006 and conducted its first nuclear test later that year on October 11. This was a test that their Foreign Ministry stressed, ‘was entirely attributable to the US nuclear threat, sanctions and pressure.’¹⁵

Initially the BDA sanction, intended to be a punishment related to international crime, was welcomed within the US and by allies in the region. However, it soon became an obstacle to progress on denuclearization and lost support. During its imposition, the sanction was said to have successfully intimidated banks from doing business with North Korea and disrupted the country's system for transferring foreign

¹² Victor Cha, March 10, 2011, Testimony before the House Committee on Homeland Security, *House of Foreign Affairs Committee on North Korea's Sea of Fire: Bullying, Brinkmanship and Blackmail*, at http://csis.org/files/ts1130310_Cha.pdf, (retrieved on 22/10/2011).

¹³ Tae-Hwan Kwak and Seung-Ho Joo, US Financial Sanctions against North Korea, 2007, *Pacific Focus*, p. 73.

¹⁴ Ambassador Christopher Hill, Assistant Secretary of State for East Asian and Pacific Affairs, Keynote Address, at AEI Conference, Sustaining the Alliance, (February 1, 2006), at <http://www.aei.org/events/print/sustaining-the-alliance-event>, (retrieved 21/11/2011).

¹⁵ Daryl Kimball and Peter Crail, Chronology of US-North Korean Nuclear and Missile Diplomacy, Arms Control Association, at <http://www.armscontrol.org/factsheets/dprkchron>, (retrieved on 21/10/2011).

exchange.¹⁶ Despite such effective financial punishment on North Korea, the US did ultimately accept that it had a ‘chilling effect on Six-Party Talks.’¹⁷ Thus, on June 14 2007, having failed to provide substantial evidence of wrongdoing on the part of the bank and under heavy diplomatic pressure, funds totaling \$25million were returned to North Korea and talks restarted.

1.2 Research Question

The reasons for the failure of the BDA sanction are the subject of this paper. The BDA had been targeted by the US in 2005 because of its financing of criminal activities as part of its wider Illicit Activities Initiative (IAI). From 2002 to 2006 the implementation of this policy saw the US Government carry out a series of multi-agency and multinational actions against the illicit activities and finances of the Kim Jong il regime.¹⁸ The mandate of the IAI was to develop non-military and non-sanction based ways and means of pressuring Kim Jong il to back away from his nuclear weapons development and missile programs by disrupting his regime’s global finances. As its architect, David Asher put it, ‘the IAI aimed to create serious and credible leverage over the leadership.’¹⁹

It chose to pressure the DPRK regime by using reputational sanctions such as the one imposed on the BDA. Through such a tool it sought to publicly sanction state banks caught supporting terrorism and proliferation. The goal of this public action was to chill investment in these private financial institutions by legitimate third

¹⁶ David Lague and Donald Greenlees, January 18, 2007 Squeeze on Banco Delta Asia hit North Korea where it hurt, *International Herald Tribune*, at <http://www.nytimes.com/2007/01/18/world/asia/18iht-north.4255039.html>, (retrieved 18/06/2011).

¹⁷ Emma Chanlett-Avery, Mark E. Manyin & Hannah Fischer, *North Korea: A Chronology of Events in 2005*, CRS Report RL33389 April 24, 2006, Congressional Research Service, Washington, DC, (2006).

¹⁸ David L. Asher, Victor D. Comras and Patrick M. Cronin, Pressure: Coercive Economic Statecraft and U.S. National Security, *Center for a New American Security*, (January 2011), p. 6.

¹⁹ Ibid, p.6.

parties. For such high-profile institutions, conducting business with state banks that have been tainted by associations with illicit activities, threatens their reputation in the international banking community. To preserve their reputation and brand, these banks would be forced to act by reducing or withdrawing their investments and dealings with the banks engaged in illegal behavior. In turn, it was hoped that this would reduce the ability of these illicit banks to finance illegal activities thereby inducing their sponsoring-states to change their behavior.²⁰ Anecdotal information suggests this tactic was effective; the seizure of North Korean funds, the steps taken by institutions in multiple states to deny financial services to the DPRK, the ultimate closure of the bank and the intense media attention that the sanctions received. However, despite successful implementation of the sanction and chilling of investment, it did not work to induce North Korea to change its behavior.

Reputational sanctions do seem to promise a new and highly useful form of coercive leverage. Yet several aspects of their operation warrant further exploration; are they actually effective in coercing the target state? Do they induce behavioral changes? Within a coercive diplomatic framework, what factors lead to successful coercion? And what is the role of domestic politics and alliance support in their implementation? An analysis of the BDA affair is able to answer some of these fundamental questions by revealing why the sanction failed as a coercive tool.

This paper addresses these areas and aims to analyze the reasons why the BDA sanction, seemingly effective in constraining North Korea's use of the international financial system and thus potentially able to coerce the regime, failed and was withdrawn. By conducting a study of the events and actions involving the key players

²⁰ Feaver, Peter D., and Eric B. Lorber, *Coercive Diplomacy, Evaluating the Consequences of Financial Sanctions*, *Legatum Institute*, (November 2010), pp. 6-7.

in the affair; the United States, as the coercer state, North Korea as the coerced state as well as South Korea and China as influential allies for either side, the period of the BDA's implementation will be investigated. A so-called coercive diplomatic framework will then be applied in order to isolate and explain the variables that led to the BDA sanction's failure and subsequent withdrawal.

1.3 Methodology

This paper will conduct a single-case explorative and historical analysis of the BDA affair based on the use of qualitative data in order to determine the reasons for its failure. Through a detailed 'thick' and holistic description it is this study's intention to explain not only the behavior of the actors involved in the event but also the timing and context of the process through contents analysis.²¹

The application of a single-case study was chosen for two reasons. The first is that there is no comprehensive historical research of the BDA sanction in the literary field, so an in-depth study and breakdown of the episode alone would be of configurative and ideographical value as such descriptions could be used for subsequent theory building. The second, as noted by George and Bennett, is that a heuristic case study which assesses the reasons for the BDA sanction's failure and attempts to unearth another variable for successful sanction application is best served by focusing upon one, rather than multiple cases.²²

²¹ Gary King, Robert O Keohane, and Sidney Verga, *Designing Social Inquiry: Scientific Inference in Qualitative Research*, (Princeton: Princeton University Press, 1994), pp. 208-212.

²² Alexander L. George, Andrew Bennett, *Case studies and theory development in the social sciences*, (Washington, 2004), pp. 73-74.

In order for this single-case study to have ‘scientific contribution’ the treatment of this historical event will utilize Jentleson’s coercive diplomatic framework in order to discover the reason why the BDA sanction was a failure. With this well-defined framework, the research can be ‘situated’, as George and Bennett indicate, in a clear class of studies, which in this case would be both that of international sanctions and coercive diplomatic models.²³ Coupled with a structured and analytical approach that will allow for replication, the application of the coercive framework will help to add external validity to this case as it establishes the domain to which this study’s findings can be generalized.²⁴ Not only will this research make contributions by summarizing historical detail and highlighting descriptive inference, but also it will be useful in evaluating causal inference and potentially add further variables to explain successful sanction implementation. Though a subsequent comparative study to test the hypotheses may be required to enhance their validity, there is still clear value in their discovery²⁵

Investigating the events surrounding; the United States, as the coercer state, North Korea as the coerced state, as well as South Korea and China as influential allies for either side, the (1) South Korea’s lack of support (2) China’s lack of support and (3) US change of objectives will be the three broad areas which will be analyzed to judge the sanction. This is further outlined in the following chapter that focuses on the definitions, framework and methodological approach of this paper.

Secondary empirical data will be used in this paper as well as speeches, press conferences, US Congressional testimonies, press reports and other documents related

²³ George & Bennett, *Case studies and theory development in the social sciences*. p. 69.

²⁴ Robert K. Yin, *Case Study Research: Design and Methods*, 3rd edition, (Thousand Oaks: Sage, 2003), pp. 34-37.

²⁵ Gary King, Robert O Keohane, and Sidney Verga, *Designing Social Inquiry: Scientific Inference in Qualitative Research*, (Princeton: Princeton University Press, 1994), pp. 208-212.

to the BDA sanction. These will act as the basis for research into this event and its consequences.

1.4 Chapter Outline

This paper will be divided into six chapters. Chapter 2 clarifies the way this study will classify the BDA, and explains why this research assumes the policy of which it was part was coercive in nature and a failure in result. It then describes the theoretical framework that will be applied to this paper and its particular implementation with regards to the BDA case itself. This is followed by a section that explains the connection between the framework and structure of the paper to the variables that Bruce Jentleson's framework asserts to be necessary to achieve success in the case of a diplomatic coercive policy. As a result of this connection the three hypotheses that will be tested in this paper are constructed and show how the theoretical framework will be used as a tool with which to understand what role each parameter of the coercive framework played in leading to the failure of the BDA. Chapter 3 provides a literary review of the current scholarly debate on economic sanctions, reputational sanctions, work on coercive diplomacy and writings on the specific case of the BDA sanction as it provides an overview of existing literature in these fields. Summarizing the extent of literature on these areas and bringing to light the limits of research on both these fields, the manner in which this paper will contribute to the field of International Relations will be outlined.

Having established the research framework, the empirical element of the research is undertaken in chapter 4. This chapter is divided into 7 chronological sections, each of which denotes a significant event within the BDA case. Drawing on sources from the US, China, South Korea and North Korea, this chapter will collate

the diverse information surrounding the BDA affair and succinctly summarize it. Chapter 5 uses the parameters of coercive diplomacy in order to understand the how and why the South Korean and Chinese Support for US-DPRK policy as well as the political goals for the sanction in the US, changed. This chapter tests the hypotheses for validity and attempts to analyze their role of each variable within the BDA case in terms of their significance in coercive diplomacy. The variables of coercive diplomacy: proportionality, reciprocity and coercive diplomacy, are used to better understand the role of these variables within the theoretical framework of this paper. Lastly, chapter 6 forms a conclusion to the study and an answer to the research question. The most significant reason or reasons for the BDA's failure as a coercive tool are discussed. Augmenting this are the implications for coercive diplomacy and reputational sanctions that can be made as a result of this research paper.

Chapter II

Research Framework: Coercive Diplomacy & BDA

This chapter seeks to outline the terminology used with regards to the BDA and the assumptions that this paper makes about the sanction. Upon doing so, it goes on to show how such assumptions determine its connection to the overall framework of the paper. Focus will be on how the features of coercive diplomacy will be utilised in order to isolate and understand the variables that led to the failure of the BDA.

2.1 BDA: Classification & Definition of Policy & Failure

It is important to clearly outline a number of definitional and theoretical aspects of this paper that require clarification. The manner in which this research classifies the BDA action and the reason why this paper assumes the sanction imposed upon the bank failed, as a coercive tool will be explained. Furthermore, with these terms and assumptions made clear, the overall framework of the paper will be defined.

2.1.1 Classification of BDA Action

Existing literature on the BDA is inconsistent in its classification of the action taken by the US Treasury against the bank. While some writers refer to it as an ordinary financial sanction, others refer to it as a measure, designation or advisory and yet others call it a reputational sanction.²⁶ It is important to note that the measure taken

²⁶ References to 'financial measure' include Victor D. Cha, *The Impossible State*, as an 'financial advisory' in United States Department of the Treasury, *Regulations*, a 'sanction' by Mike Chinoy,

against the BDA was not a financial sanction but rather a financial advisory to US institutions to beware of business with BDA because of money-laundering concerns. This means that a bank or jurisdiction (a region or country) designated by Treasury as a ‘primary money laundering concern’ can be made the subject of one or more of five Patriot Act Section 311 ‘special measures.’ Under this special measure, US financial institutions are prohibited from having accounts within the US with the designated bank or jurisdiction and are required to guard against indirect use of US accounts by the designated bank or jurisdiction through other overseas banks.

Prior to the BDA affair, only four other banks and one jurisdiction had been the subject of the fifth special sanction: Myanmar Mayflower Bank and Asia Wealth Bank (Burma), Burma (the entire country), Commercial Bank of Syria and VEF Banka (Latvia).²⁷ Thus, in purely linguistic terms, the original action taken when imposing section 311 of the Patriot Act is in fact a measure, meaning a legal instruments implementing restrictive measures that do not address the political process leading to the decision to impose or repeal such restrictive measures.²⁸ However, the scope and consequences of such a measure mean that it must be looked at in a broader manner as a sanction.

2.1.2 BDA as a Reputational Sanction

It is this paper’s assertion that the BDA action was not only a sanction, but that

Meltdown and a ‘reputational sanction’ by Peter D. Feaver and Eric B. Lorber, Coercive Diplomacy, Evaluating the Consequences of Financial Sanctions.

²⁷ United States Department of the Treasury, Regulations - Imposition of Special Measure against Banco Delta Asia SARL, http://www.fincen.gov/statutes_regs/patriot/pdf/specialmeasurebda.pdf, September 12, 2005, (retrieved 21/04/2012).

²⁸ Council of the European Union, Guidelines on Implementation and Evaluation of Restrictive Measures (Sanctions) in the Framework of the EU common Foreign and Security Policy, 17464/09, Brussels, 15 December, 2009, ((retrieved 14/08/2012). <http://register.consilium.europa.eu/pdf/en/09/st17/st17464.en09.pdf>

it was more specifically a reputational sanction as the IAI sought to undermine the reputation of institutions that were helping North Korea to conduct illicit activities. As Feaver and Lorber highlight, measures taken to ‘name and shame’ are effectively sanctions as the impositions that they carry are considered more effective than traditional sanctions and are bound by international law.²⁹

These sanctions were introduced as part of the domestic and international response to the 9/11 terrorists attacks, which involved dramatic changes to the international financial regulatory framework, they attack the reputational integrity of private firms. Though reputational sanctions do not, unlike traditional sanctions, directly freeze or seize assets directly (in the BDA affair, funds were seized not by the US but by the Macau government), or physically impede the business and trade of target states and companies, rather they devalue the market commodity of trust. A reputation for reliability enhances the opportunities for future business transactions of a bank or company, if this trust is lost then this can seriously damage the extent to which it can business. As such, reputation can be considered to be a form of capital, even more important than a company’s financial assets. In fact, some argue that while financial capital can be regained, it is much more difficult do rebuild a reputation that has been damaged.³⁰ It is in this sense that they can be said to have the characteristics of an economic sanction and be more specifically labeled a reputational sanction.

These new financial sanctions should generate at least two effects – a direct effect imposed on the targeted institution by the sender state (the United States government and its partners) and an indirect effect imposed by the rest of the financial

²⁹ Peter D. Feaver and Eric B. Lorber, *Coercive Diplomacy*, pp. 25-27.

³⁰ Judith van Erp, Reputational Sanctions in Private and Public Relations, *Erasmus Law Review* Volume 01 Issue 05, 2007, pp. 146-148.

system. The indirect effect leverages reputation, specifically the reputational concerns that banks and other financial institutions have about dealing with tainted (“designated”) entities. Such sanctions are derived from the financial world, where the reputation of an institution is considered an asset in terms of its importance in determining the level of market trust of the organization.³¹

It is possible in theory that reputational effects are substantial in the commercial world and insubstantial in the political world. Reputation matters when dealing with political-economic issues involving private corporations but not when dealing with security concerns involving governments – would raise interesting questions for the new financial sanctions, which straddle both. In designating the BDA sanction as reputational, we can seek to tackle these questions by seeing if the sanction did damage the reputation of the BDA to reduce the chance of future deals and can damage the extent.

2.1.3 BDA Policy as Coercive

Having established that the BDA was a reputational sanction, it is now important to explain the reason this paper assumes that the policy of which it was part was coercive, as it is not the sanction in isolation that will be analysis, rather the broader policy. Such a determination provides the foundation of reason for the judgment of its failure that appears in the following section and allows the central theoretical framework of this paper, Bruce Jentleson’s coercive diplomacy, to be applicable to this case. Thus, it is important to outline the features of the policy of which the BDA was central and note the distinction between the Bush DPRK policy of ‘hawk engagement’ before and after its implementation.

³¹ Peter D. Feaver and Eric B. Lorber, *Coercive Diplomacy*, pp. 30.

Prior to the introduction of the BDA, the US was implementing an engagement rather than coercive policy. Begun in 2004 and led by Victor Cha, his 'hawk engagement' policy was composed of three core elements: (1) containment-plus-engagement by having a robust US-ROK military defense posture capable of deterring a second invasion. This was policy was complemented by conditional diplomatic and economic inducements to curb the proliferation threat and shape North Korean behavior in more cooperative ways. (2) Support of engagement with Pyongyang not because the regime is crazy, near collapse, or misunderstood, but because engagement can prevent the crystallization of conditions under which Pyongyang could calculate aggression as a 'rational' course of action even if a DPRK victory were impossible. (3) Engagement would not only provide insight on the degree of change in DPRK intentions, but would also lay the groundwork for punishment if the regime fails to fulfill its obligations.³² Cha did not advocate the use of sanctions as they were 'unlikely to elicit a positive change in behavior' and often signaled a hardliner tendency to 'proceeding prematurely to a coercive policy' that without South Korean and Chinese support lacked 'formation of a regional consensus'. Instead, by applying the notion that 'today's carrots are tomorrow's most effective sticks', he actually stressed that if North Korea was given a stake in the status quo by lifting sanctions, then their re-imposition if 'it fails to live up to its commitments', can punish the state and be effective. He clearly advocated engagement over coercion.³³

The use of the BDA sanction did not match the three elements of hawk

³² Victor D. Cha, Hawk Engagement and Preventive Defense on the Korean Peninsula, *International Security*, volume 27, issue 1, pages 40-78, Summer 2002, p. 44.

³³ Victor D. Cha and David C. Kang, *Nuclear North Korea: A Debate on Engagement Strategies*, pp. 91-92. And, Victor D. Cha, *Hawk Engagement and Preventive Defense on the Korean Peninsula*, p. 71.

engagement as it was not used at a point when North Korea has not followed through with one of its promises; a point of failure. However, the sanction was instead seemingly implemented to cause the failure of a point of success; the signing of the 9.19 Agreement. Therefore, the post BDA period cannot be said to be an extension of hawk engagement. It is this paper's assumption that the post BDA period was actually the beginning of a hardliner US policy that was coercive in nature.

In order to show that there is clear a difference between the pre and post-BDA period of US policy, it is important to compare and highlight the difference of the two policies and the manner in which Hawk Engagement effectively became 'Hawk Coercion'.

Table 2.1
Hawk Engagement and Hawk Coercion Strategies

Policy Characteristics	Hawk Engagement	Hawk Coercion
Hawk Engagement Assumption about Target State's Intentions	North Korean intentions revisionist, unchangeable	North Korean intentions revisionist, unchangeable
Source of Threat from Target State	North Korean coercive bargaining behavior	Nuclearization
Approach	Engagement, stake in status quo, sanctions only in response to failure	Application of sanctions to 'squeeze' the regime, while engaging
Policy Goal	Expose North Korean lack of good faith; rally support for punishment	Pressure North Korea and coerce to negotiate by providing leverage
Ultimate objective	Unification with South Korea and absorption of North Korea	Unification with South Korea and absorption of North Korea
Attitude toward potential Risk	Risk acceptant	High Risk acceptant

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³⁴ Figure 2.1 was made by S. Blakeley and is based upon information gathered both from Victor D. Cha and David C. Kang, *Nuclear North Korea: A Debate on Engagement Strategies* and Victor D. Cha, Hawk Engagement and Preventive Defense on the Korean Peninsula, *International Security*, volume 27, issue 1, pages 40-78, *Summer 2002*. These texts were used to establish the six features of Hawk engagement. The features of 'Hawk Coercion' were established using direct quotes from Mike Chinoy's Meltdown, wherein such figures as Secretary of State, Condellezza Rice, noted that the North Korea policy was designed to 'On the one hand we will squeeze. On the other hand we'll talk' and David L. Asher, Victor D. Comras and Patrick M. Cronin's Pressure: Coercive Economic Statecraft and U.S. National Security, *Center for a New American Security*, (January 2011), p. 6.

A comparison of US policy before and after the BDA's implementation demonstrates the changes that took place as engagement turned to coercion. Whilst we can assume that North Korea's intentions are revisionist and that the ultimate objective of the two policies is unification with South Korea and absorption of North Korea remain the same, the source of threat, ultimate objective, policy goal, approach and attitude to risk, change. Post-BDA, there is a greater sense of threat as the DPRK announces progress on nuclearization, the acceptance of risk is higher as hardliners ignore DPRK threats and maintain the implementation of the BDA. Moreover, with the policy goal of destabilization and coercion to negotiate rather than exposing DPRK lack of faith and rallying the support of allies for punishment, and regime change as the objective, the approach is more aggressive. Sanctions, only to be used in response to North Korean failure to live up to commitment, are actively applied to 'squeeze' and coerce the regime. This paper thus assumes that post-BDA US policy is better termed 'hawk coercion' than 'hawk engagement' as it exhibits characteristics of coercive diplomacy that differ to those to which Victor Cha outlined.

In order to show that Bruce Jentleson's framework is applicable to this policy, it is also important to show that the characteristics of coercive diplomacy - motivation, demand, credibility, a balance of carrot and stick and a sense of urgency - are also evident in hawk coercion. These characteristics have been highlighted in the table below.

Table 2.2
Hawk Coercion & Bruce Jentleson's Framework

Motivation	Demand	Credibility	Carrot	Stick	Urgency
Denuclearization with a view to Regime Change	(1) Denuclearization (1)End to Illicit Activities (2)Improved Human Rights	(1) Military (1)Political (2)Economic	Talks	BDA Sanction	20 Dec 2005: North Korea says it intends to resume building nuclear reactors. 5 & 6 July 2006: North Korea test-fires seven missiles. 9 Oct: North Korea announces that it has performed its first-ever nuclear weapon test.

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The six characteristics, as presented in the table above and elaborated below, of coercive diplomacy in place, are valid in this paper to assert that this was not an engagement policy but rather a coercive policy. It was less ‘hawk engagement’ and more ‘hawk coercion’ – a term reflecting Washington hawk’s use of the tool to move away from a policy of engagement to a coercive policy of ‘squeeze and talk’; squeezing the DPRK financially through sanctions whilst attempting to maintain talks on denuclearization.³⁶ It is clear then, that this policy exhibited the characteristics of coercion as outlined by Bruce Jentleson and thus an analysis using his framework is applicable.

2.1.4 BDA as a Coercive Failure

Having established that the BDA sanction was part of a coercive policy, it is now important to explain why it is that this paper assumes it to have failed as a coercive tool.

³⁵ Figure 2.2 was made by S. Blakeley and is based upon the theoretical framework of Bruce Jentleson as outlined in Bruce Jentleson and Christopher A. Whytock, *Who “Won” Libya? The Force-Diplomacy Debate and Its Implications for Theory and Policy*. The fields were populated from the policy outline in David L. Asher, Victor D. Comras and Patrick M. Cronin’s *Pressure: Coercive Economic Statecraft and U.S. National Security*, *Center for a New American Security*, (January 2011), p. 6.

³⁶ Brinkley, Joel, *US Squeezes North Korea’s Money Flow*, *The New York Times*, March 10, 2006.

Upon its initiation, the US Department of Treasury indicated that through its implementation of special sanctions against BDA it intended to ‘bring criminal conduct occurring at or through Banco Delta Asia to the attention of the international financial community and, further limit the bank’s ability to be used for money laundering or for other criminal purposes.’³⁷ With such a goal in mind, the subsequent seizure of funds, the steps taken by institutions in multiple states to deny financial services to the DPRK, the ultimate closure of the bank and the intense media attention that the sanctions received, it is clear that the ‘attention of the financial community’ was achieved and that the ‘bank’s ability to be used for money laundering or for other illegal purpose’ was certainly curtailed. Thus, the sanction was a success under these two parameters of judgment. Motivated by a need to tackle international state-led crime, the sanction can be deemed to have been appropriate and a success in completing this intended limited and financial goal.

In terms of the BDA’s use as a reputational sanction, it can also be considered to have been a success. These new financial sanctions should have two fundamental effects – a direct effect imposed on the targeted institution by the sender state and an indirect effect imposed by the rest of the financial system. The BDA sanction succeeded in doing this. Directly, it caused the freezing of North Korean funds and the ultimate closure of the Macao Bank, indirectly, 20 or more institutions worldwide stopped financial services to North Korea as a consequence of the sanction imposed on BDA. However, in broader terms, it aimed to create serious and credible leverage over the leadership of North Korea and help to dissuade Kim Jong il from pursuing nuclear weapons, thus the success of the sanction must be framed in terms of the wider policy to which it belonged.

³⁷ Treasury Department, US Government, Federal Register/Vol. 70, No. 181/Tuesday, (September 20, 2005).

Though such figures as Undersecretary of States for Arms Control, Bob Joseph stressed that the BDA sanction was ‘independent of the diplomatic efforts that we are pursuing,’ they were in fact linked and intended to create ‘serious and credible leverage’ as a ‘means of pressuring Kim Jong il to back away from his nuclear weapons development and missile programs.’³⁸ Adopted and maintained by hardliners in the government that advocated ‘squeeze them, but keep the negotiations going’ logic to the imposition of BDA, the sanction became not merely a matter of international crime, but a tool of coercion. This was a tool that was supposed to impede North Korea financially and coerce it into ending its nuclear program but failed to do so. Instead it became increasingly apparent that finding a way out of the BDA deadlock was central to broader progress on the nuclear issue, as it became a huge stumbling block.

Having been a success in hampering North Korea’s ability to function in international finance, it could have been withdrawn as was advocated by allies and State Department pragmatists alike, but as I will show below, hardliners seized on the sanction and altered its objective. It thus became, not an isolated financial sanction, but a tool of coercive diplomacy. However, it was a failure in this role as rather than coerce the DPRK to follow US requests to end nuclearization, the DPRK reacted with missile launches and its first nuclear test and successfully resisted coercive efforts to return to Six-Party Talks until the promise of the sanction’s withdrawal was made. It is in this sense that this paper regards the BDA sanction to have become part of a broader coercive diplomatic policy and ultimately a failed tool of coercion that had to be withdrawn.

³⁸ Asher, Comras and Cronin, *Pressure: Coercive Economic Statecraft and U.S. National Security*, p. 6.

2.2 BDA & Jentleson's Framework

This paper's assumption that the BDA was a tool of coercive diplomatic policy means that Bruce Jentleson's parameters for the success of such a policy are also applicable to it. It is with this assumption in mind that one can analyze the reasons for the BDA sanction's failure using his parameters of proportionality, reciprocity and coercive credibility.³⁹

Jentleson argues that there are two variables that determine the success or failure of coercive diplomacy: one, the coercer state's strategy and the other, the conditions of the target state's domestic politics and economy. In order to affect success in variable one, state strategy, the coercer state must construct a strategy that makes the costs of noncompliance higher than those of compliance. This is dependent upon an appropriate balance of the criteria of proportionality, reciprocity and coercive credibility, each of which requires particular inspection in order to understand the role that it has and how it can be achieved.

Proportionality refers to the relationship between the scope and nature of the objectives being pursued and the instruments being used in their pursuit. The more the coercer demands of the target, the higher the target's costs of compliance become, thus the greater the need for the coercer's strategy to increase the costs of non-compliance and the benefits of compliance. There must be proportionality between the ends and the means in order to make the policy credible. As the means in coercive diplomacy are limited and fall short of full-scale war, the ends are also limited.

³⁹ Bruce Jentleson and Christopher A. Whytock, Who "Won" Libya? The Force-Diplomacy Debate and Its Implications for Theory and Policy, *International Security*, Volume 30, Number 3, Winter 2005/6 (MIT Press), pp. 51-52.

Though more limited objectives does not necessarily mean an increased likelihood of success, the balance of the ‘objectives pursued and the leverage applied’ must be properly established to create a proportional relationship between the two.⁴⁰

Reciprocity involves an explicit or at least mutually tacit understanding of linkage between the coercer’s carrots and the target’s concessions. Whether incremental or not, mutual confidence must exist so that the target state knows it cannot receive the benefits without having to reciprocate and the coercer state must ensure that the target state is confident that upon making concessions, benefits will be reciprocated. Whether the BDA sanction was properly implemented to allow for such reciprocity to be built between the US and North Korea will be investigated.⁴¹

Coercive credibility requires that, in addition to calculations about costs and benefits of cooperation, the coercer state convincingly convey to the target state that non-cooperation has consequences. Threats, actual use of force and other coercive measures such as sanctions, must be sufficiently credible to raise the target’s perceived costs of noncompliance. A superior military or economic position in the case of the coercer is insufficient, as multilateral support is also needed to make threats credible. Establishing a common interest with an ally, ensuring that the objective of the policy is perceived to be reasonable and holding credible strength to execute threats made towards the target state, attains such multilateral support. Thus the role of allies as key elements of engagement with North Korea will also be looked at to gauge whether the BDA sanction held enough credibility.⁴²

⁴⁰ Jentleson and Whytock, *Who “Won” Libya?* pp. 51-52.

⁴¹ Ibid, p. 52.

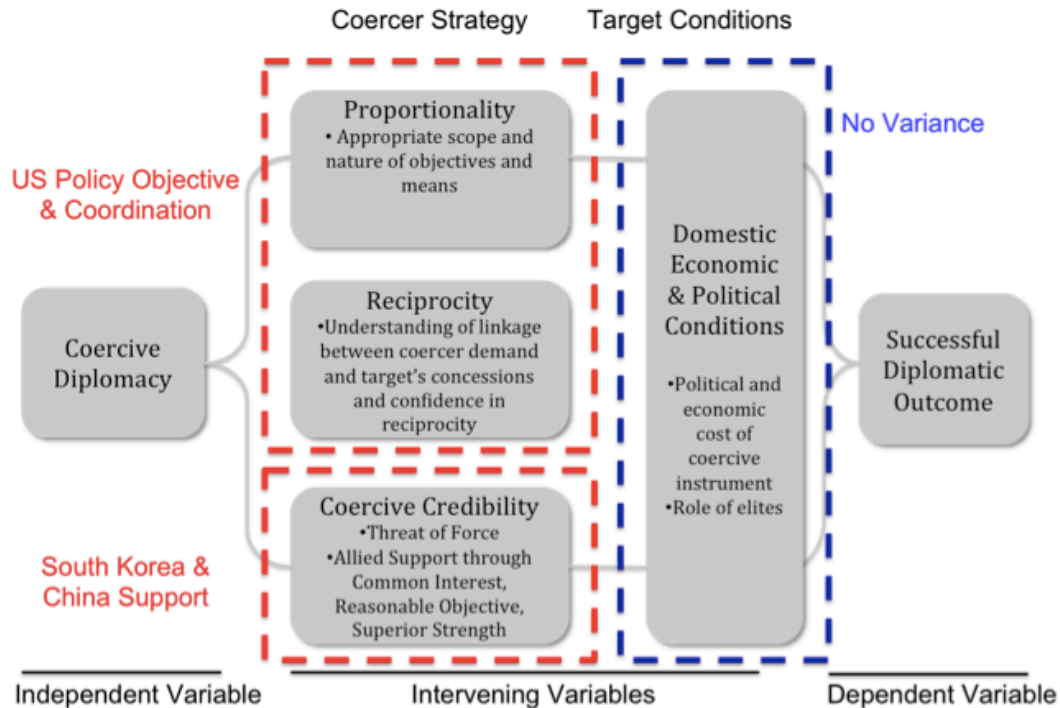
⁴² Ibid, p. 53.

In relation to the target's domestic political and economic conditions, the costs of compliance and non-compliance are relative to regime survival and economic capacity, as well as the ability of the ruling elite to insulate the effects of coercive sanctions are significant. Such variables must be controlled and balanced as depicted below in order for coercive diplomacy to be a success.

An assessment of the coercer strategy and the North Korean economy will form the central framework of this research whereby the ability of the BDA sanction to attain the three primary elements of the coercer strategy; proportionality, reciprocity and coercive credibility, lead to the non-withdrawal and successful maintenance of the coercive sanction.⁴³ Application of this framework provides a theoretical construct with which to analyze the reasons why the BDA was ultimately withdrawn. This paper's theoretical structure will be as follows:

⁴³ Jentleson and Whytock, *Who "Won" Libya?* p. 53.

Figure 2.3
Jentleson's Framework & Research Structure



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For the independent variable (coercive diplomacy) to lead to the dependent variable of success, the intervening variables (coercer strategy + target conditions) need to be attained. Within these the coercer strategy requires proportionality, reciprocity and coercive credibility and the target conditions should be conducive to successful sanctioning. This paper will isolate coercer strategy and does not deal with the domestic economic and political conditions. This decision has been made because firstly, they remain unchanged throughout the BDA affair and lack variance. Secondly, in practical terms, it would require more time and a lengthier research

⁴⁴ Figure 2.3 was made by S. Blakeley and is based upon the theoretical framework of Bruce Jentleson as outlined in Bruce Jentleson and Christopher A. Whytock, *Who "Won" Libya? The Force-Diplomacy Debate and Its Implications for Theory and Policy*. The blocks in blue, 'no variance' and in red, 'US policy objective & coordination' and 'China & South Korea support' are the indicators that this paper uses in order to measure the variables extracted from Jentleson's framework.

project than is possible here.

Therefore, as per figure 2.3, proportionality and reciprocity will be gauged by researching the manner of change in objective and coordination of the US policy and coercive credibility by looking at the support given to the sanction by both China and South Korea; the two states most closely related to the affair. Although there are other Six-Party Talks members such as Russia or Japan that are connected to events related to North Korea, they are not as relevant to this research. The BDA bank was actually geographically located in Macau, mainland China and the Chinese are the most significant economic partner of the DPRK whose actions have direct implications on the sanction imposition of North Korea. However, it was South Korea, who as their neighbor and second-largest trade partner as well as being a keen US ally that was most influential in this case.

Using such a framework to isolate the variables for this complex affair, and measuring each of their influence in terms of the definite and concrete actions of each key player related to the BDA will allow for a worthwhile and structured analysis of this event. In order to understand where this study stands in terms of the existing literature on sanctions and coercive diplomacy and how it will contribute to this scholarly field, a broader understanding of the current literature must be made.

2.3 Hypotheses

The previous sections explained the assumptions of this paper and their connection to the overall framework of the study; this section, will outline the hypotheses under investigation. By looking at the influential roles of South Korea, China and the internal domestic politics of the United States in determining the outcome of the

sanction, the reason for the BDA's failure will be found. In order to do this, Jentleson's framework, as outlined in the previous chapter, was used to isolate the determinate variables connected to these actors in order to elucidate the main arguments of this paper. Jentleson's framework directly provides the three variables that this paper will measure, coercive credibility, proportionality and reciprocity. In order to measure these the indicators, of US policy change and co-ordination (proportionality and reciprocity) and China and South Korea support (coercive credibility), will be used. These indicators will allow me to verify or falsify the three following propositions that have been hypothesized.

2.3.1 Hypothesis 1

- **Lack of coercive credibility leads to the failure of a sanction**

Despite a difference in policy priorities, a sanction, when limited to its objective of punishing a target state for an international crime, is successful if supported by the coercer state and its immediate allies. This support is essential in order for the coercer state to achieve coercive credibility that allows it to convincingly convey to the target state that non-cooperation has consequences. If support for the action is gradually weakened, then it will fail. If it is unable to establish an enduring common interest between the coercer state and its allies and maintain a perception that the objective is reasonable then it will fail as the lack of support weakens the coercive credibility of the sanction.

In order to determine whether there was coercive credibility in the implementation of the BDA coercive policy, this paper will analyze the interests of the US and its allies, South Korea and China. As ensuring that the objective of the policy is perceived to be reasonable and holding credible strength to execute threats

made towards the target state, attains such multilateral support, these two parameters will be focused upon to gauge whether the BDA sanction held enough credibility.

2.3.2 Hypothesis 2

- **Lack of proportionality leads to the failure of a sanction**

When issued, a sanction's objectives are initially limited to punishing a state for an international crime it will succeed in fulfilling its direct purpose. That is, the relationship between the scope and nature of the objectives being pursued and the instruments being used in their pursuit must be proportional. However, once political groups within the coercer state as a tool of coercive diplomacy and its objective broadened to act as leverage, and imbalance the policy causes disproportionality that makes it unsustainable. This change in objective causes an imbalance in proportionality and means that coercer demands of the target exceed the benefits of compliance and leads to the failure of the sanction.

In order to determine whether there was proportionality in the implementation of the BDA coercive policy, this paper will analyze the changes in US policy goals. As the balance of the objectives pursued and the leverage applied must be properly established to create a proportional relationship between the two, a study of these changes can be used in order to determine whether such proportionality was achieved.

2.3.3 Hypothesis 3

- **Lack of reciprocity leads to the failure of a sanction**

An inability or unwillingness to respond to indicators exhibited by the target state and the decision to implement a sanction at a time when the target state is made to feel it had been punished undeservedly effectively erodes reciprocity. This causes the target state to feel its concessions would not be met with reciprocal benefits even if it complies with the demands of the coercer state. Whether incremental or not, mutual confidence must exist so that the target state knows it cannot receive the benefits without having to reciprocate and the coercer state must ensure that the target state is confident that upon making concessions, benefits will be reciprocated. Without the appropriate reciprocity in place for concessions and benefits to be exchanged and coercion to ensue this leads to the failure of the sanction.

In order to determine whether there was reciprocity in the implementation of the BDA coercive policy, this paper will analyze the timing and the ability of the US administration to react to indicators, as it is through these that reciprocal confidence can be made. Mapping out the seven key events of the BDA affair, the indicators by North Korea and reaction of the United States will be outlined and compared to seeing if they were reciprocal in nature.

In order to verify or falsify these hypotheses, a descriptive analysis of the events surrounding the BDA incident and a subsequent analysis of the roles of South Korea, China and the internal domestic politics of the United States had in its failure. A descriptive analysis of the events of the BDA sanction will be conducted in the following chapter.

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Chapter III

Literature Review:

Economic Sanctions, Coercive Diplomacy & North Korea

As the framework for this research is now clear, it is now important to understand the current literature on sanctions to see the value of this work. With this in mind, this paper broadly focuses on three areas of International Relations: that of economic sanctions, their role in coercive diplomacy and relations with North Korea. The literature on these areas is both diverse and comprehensive. The complexity of each of these fields means that there is an abundance of scholarly work from the fields of Political Economy, International Relations and Security. Although literature on the BDA affair itself is limited to mainly prescriptive analysis and journalist pieces, the material found on these broad groups can provide a framework and guideline that this paper can follow. This chapter will review the arguments presented in the literature on these areas and present it in the form of the aforementioned categories of literature on economic sanctions, coercive diplomacy and economic sanctions on North Korea itself.

3.1 Economic Sanctions

Current literature on sanctions can be grouped into four main types of studies. The first emphasizes single-case studies upon the impact of sanctions and the second, the success of sanctions under broader definitions through comparative analysis. The two groups are followed by a third that highlights the use of sanctions as a means to signal or reveal intent on the international stage and fourth that relates to the significance of the role of cooperation in sanction implementation. It is into a new and fifth group of

‘smart sanctions’, which this study will seek to contribute to.

Single-case studies seek to ascertain the effectiveness of sanctions in causing policy change. John Galtung developed a model for society’s responses to them, and outlined people’s ability to undermine their effectiveness through his psychological and exploratory study of the practical strategies applied by people in Rhodesia as countersanctions to British sanctions. This research offered an insightful assessment of the problems entailed in making sanctions effective and lead to the establishment of a series of conditions for sanctions to be effective. Galtung particularly emphasizes the need for universal compliance by all countries to effectively isolate the target states and have the sanction ‘bite’ as well as ‘work’.⁴⁵

Using such studies as a platform, the second type of study, led by such scholars as Gary Hufbauer, Jeffrey Schott, Kimberley Elliott and David Baldwin, broadened the definition of success, outlining definitions, variables and determinates, thus constructing a framework for sanction success to include signaling, policy manipulation and regime change. Applying their collection of statistics on most of the sanctions implemented throughout the 20th century they identified the variables needed to succeed to a desired policy change. The study noted that there was a 34% success rate across the sanctions analyzed (though Robert Page later disputed this and claimed that only 5 of the 40 deemed successful were actually so).⁴⁶ Such scholars as Baldwin, advanced the field by accepting the relative ineffectiveness of sanctions

⁴⁵ Johan Galtung, On the Effects of International Economic Sanctions, *World Politics*, Vol. 19, No. 3 (April 1967), pp. 411-414.

⁴⁶ Gary Clyde Hufbauer, Jeffrey J. Schott, Kimberly Ann Elliott and Barbara Oegg. 2007. *Economic Sanctions Reconsidered, 3rd Edition*, (Washington: Peterson Institute for International Economics), pp. 160-167. And, Robert A. Pape, Why economic sanctions still do not work, *International Security*, Vol.22 No.2, (Fall 1997), p. 67.

according to statistical evidence but highlighting their appeal as a policy sanction that can demonstrate resolve and act as a sign of intention on the international stage.⁴⁷

The third stage of sanctions literature relates to issues beyond their successful application. Like Baldwin, they stress that sanctions can be implemented for other reasons than the inducement of a policy change from the target nation. However, rather than focusing on the use of sanctions as a signal or reputation-destroyer, they stress the economic benefits of particular sanctions on domestic interest groups. The fourth stage revolves around the role of cooperation in their implementation and effectiveness. Costs were found to significantly impact the level of cooperation, and cooperation levels were discovered to be higher when international institutions implemented sanctions and trends of bandwagoning were also found amongst potential implementers of sanctions. These four stages bring the current scholastic debate to an end.⁴⁸

The emerging tool of coercive statecraft termed the ‘reputational’ financial sanction by Feaver and Lorber heads the new group of sanctions. This has been employed by the United States against Iranian and North Korean banks, with an aim to impede investment into these countries by threatening the financial reputations of legitimate institutions in an interconnected world. They have received press attention and policymakers have named them as the key to ‘smart sanctions’ as they are both discriminating and effective.⁴⁹ This is the new group of sanction study to which my research seeks to contribute.

⁴⁷ David A. Baldwin, *Economic Statecraft*, 1985, (New Jersey: Princeton University Press), pp. 371-372.

⁴⁸ Lisa L. Martin, *Coercive Cooperation: Explaining Multilateral Economic Sanctions*, 1992, (Princeton, New Jersey: Princeton University Press), p. 5.

⁴⁹ Peter D. Feaver and Eric B. Lorber, *Coercive Diplomacy, Evaluating the Consequences of Financial Sanctions*, *Legatum Institute*, November 2010, p. 6.

3.2 Coercive Diplomacy

As well as substantial literature on sanctions themselves, there is also a lot of literature on coercive diplomacy. International relations literature notes that coercive diplomacy has two primary characteristics: first, it is meant to change the target's behavior; and second, it does so by threatening suffering (including, but not necessarily the use of force) in limited amounts.⁵⁰ In contrast to what Thomas Schelling describes as brute force, the purpose of coercion is not to eradicate the adversary, but rather cause him to adjust. According to Schelling, this can take the form of a mathematical formula, calculating the increment of pain needed to break the will of the target to resist.⁵¹ Later, Ellsberg, in "Theory and Practice of Blackmail" added to the field by identifying a simple formula that specified the "critical risk," the point at which, if you thought the probability of punishment was greater, you would comply and, if you thought the probability of punishment was less, you would not comply.⁵² Such research particularly focused on the interactive process between the target and sender.

Augmenting the scholarly debate, literature began to look at the reasons why coerced states would not comply despite harsh punishment. James Fearon and Michael Tomz showed that backing down as a result of a coercive threat could have significant domestic political consequences in the form of audience costs - the domestic price a leader would pay for making foreign threats and then backing

⁵⁰ Robert Art, *The United States and Coercive Diplomacy: What Do We Know?* in Robert Art and Patrick Cronin eds., *The United States and Coercive Diplomacy* (Washington D.C.: United States Institute of Peace, 2003). Other classic texts related to coercive diplomacy include: Thomas Schelling, *Arms and Influence* (New Haven: Yale University Press, 1966), and *The Strategy of Conflict* (Cambridge: Harvard University Press, 1981), Daniel Ellsberg, *The Theory and Practice of Blackmail*, P-3883, RAND Corporation, July 1968, Alexander George, *Forceful Persuasion: Coercive Diplomacy as an Alternative to War* (Washington D.C.: United States Institute of Peace, 1991) and Bruce Jentleson, *Coercive Diplomacy: Scope and Limits in the Contemporary World*, (New York: W.W. Norton & Co., 2006).

⁵¹ Thomas Schelling, *Arms and Influence*, (New Haven: Yale University Press, 1966), p.3.

⁵² Daniel Ellsberg, "The Theory and Practice of Blackmail," (RAND Corporation, 1968)

down.⁵³ Shelling noted that clarity of threat also affects the success of coercive diplomacy to provide wiggle room to overcome the face-saving constraint while avoiding the chance of vagueness causing misunderstandings.⁵⁴

Furthermore, interesting research by David Baldwin also noted that the size of the coercer state did not necessarily make the policy more likely to be successful. He suggests that the larger state may be systematically disadvantaged in such competitions of mutual pain. Because the state is larger, the consequences of losing the issue at stake are often, *ceteris paribus*, less significant, and therefore the larger state will not fight as hard for the issue.⁵⁵ Robert Keohane and Joseph Nye distinguished between sensitivity and vulnerability interdependence as they highlighted the ability of the target to shift the pain from less to more tolerable forms.⁵⁶ Work by Bruce Jentleson that focused on understanding why US policy had worked to coerce Libya to give up its nuclear program in 2003 also highlighted the need for reciprocity in relationships between coercer and target states.⁵⁷

3.3 Economic Sanctions on North Korea

With specific reference to the use of financial sanctions on North Korea, it is clear that this is a divisive subject that has been discussed by a number of prominent scholars. Haggard and Nolan note that the impositions of sanctions may be effective but only if augmented with other economic concessions in the long-term, stressing

⁵³ On this bargaining point, see James Fearon, "Domestic Political Audiences and Escalation of International Disputes," *American Political Science Review* vol.88, No.3 (1994) and Michael Tomz, "Domestic Audience Costs in International Relations: An Experimental Approach," *International Organization* vol.61, (2007), pp. 821-840.

⁵⁴ Schelling *Arms and Influence*, pp.43-51.

⁵⁵ Baldwin, David A. 1985, *Economic Statecraft*, pp. 360-364.

⁵⁶ Robert Keohane and Joseph Nye, 1977, *Power and Interdependence*.

⁵⁷ Bruce Jentleson, *Coercive Diplomacy: Scope and Limits in the Contemporary World*, 2006.

that when used in isolation they were not likely to have an effect.⁵⁸ Regarding sanctions initiated in 2009, after North Korea's second nuclear test, Marcus Noland noted that they had had 'no perceptible effect' as it would not 'have much effect on North Korea trades with China.'⁵⁹ Ruediger Frank explains that sanctions are a non-friendly, aggressive policy with a shaky legal and moral foundation and should therefore be applied, if at all, with care and only as part of a well-defined strategy.⁶⁰ Victor Cha also asserts that the imposition of sanctions is unlikely to cause positive behavioral changes with regards to North Korea, and though advocating their imposition, notes that they may lead to war rather than a collapse of the regime.⁶¹ Others like Leon Sigal emphasize the notion that despite some having had some success with financial sanctions in North Korea, there need to be incentives and engagement as well as he argues, 'leverage without negotiations makes no sense.'⁶² These are just a selection of the works that have centered on the imposition of sanctions upon North Korea.

On the specific episode of the BDA sanction there is little analysis to be found in existing data. There are writers such as Mike Chinoy, in his book *Meltdown* and James Pritchard in *Failed Diplomacy*, and most recently Victor Cha in his book *The Impossible State*, that give accounts of the events surrounding the BDA affair. Chinoy and Pritchard use analyses intelligence documents and material gathered through over

⁵⁸ Stephen Haggard, Marcus Noland, *Famine in North Korea, Markets, Aid and Reform*, (New York, Columbia University Press, 2007), pp. 140-141. And, Working Paper Series WP 09, *Sanctioning North Korea: The Political Economy of Denuclearization and Proliferation*, (4 July 2009).

⁵⁹ Blaine Harden, Value of U.N. Sanctions on North Korea Disputed, June 12, 2009, *Washington Post*, <http://www.washingtonpost.com/wp-dyn/content/article/2009/06/11/AR2009061102323.html>, (retrieved 24/10/2011).

⁶⁰ Ruediger Frank, The Political Economy of sanctions against North Korea, *Asian Perspective*, Vol. 30, No. 3, 2006, p. 536.

⁶¹ Victor D. Cha and David C. Kang, *Nuclear North Korea: A Debate on Engagement Strategies* (New York, Columbia University Press, 2003), pp. 91-92. And, Victor D. Cha, Testimony of Dr. Victor D. Cha before the United States House of Representatives, Committee on Foreign Affairs, March 10, 2011 (CSIS, 2011), p. 5.

⁶² Leon V. Sigal, An Instinct for the Capillaries, *Policy Forum Online 06-36A*: May 9th, 2006 <http://www.nautilus.org/publications/essays/napsnet/forum/security/0636Sigal.html#sect2>, (retrieved 19/06/2011).

two hundred interviews to provide a chronological description of the events surrounding the BDA. Cha, as part of the Bush team that dealt with the BDA incident, also provides insight into what motivated decisions. Even though such literature highlights the influential roles of South Korea, China and the internal domestic politics of the United States, none of these writers tackle the incident fully or view it through the framework of the coercive diplomacy model.

3.4 Scholarly Contribution

While it is clear that there is a lot of literature on the areas of smart economic sanctions, coercive diplomacy and sanctions on North Korea, there are significant limits to the current research that this paper seeks to expand upon.

Firstly, this paper intends to contribute to a newly growing fourth group of sanction study by looking at the ‘reputational’ financial sanction. Such sanctions have been employed by the United States against Iranian and North Korean banks, with an aim to impede investment into these countries by threatening the financial reputations of legitimate institutions in an interconnected world.⁶³ Though some research has been conducted by Feaver and Lorber on this new form of sanction, a paper that frames these ‘reputational’ financial sanctions in the context of the traditional literature on coercion theory and economic sanctions can contribute to the better understanding of these tools so they may be most effectively employed in economic coercive statecraft.

Secondly, and more specifically, conducting such research through a study of the BDA affair will contribute significantly to the scholarly debate on the

⁶³ Feaver & Lorber, *Coercive Diplomacy, Evaluating the Consequences of Financial Sanctions*, p. 6.

effectiveness of sanctions towards North Korea. A deeper understanding of the domestic political dynamics that existed in the US during the period studied in this paper and the reaction of the main players related to the Korean peninsula as well as North Korea itself will undoubtedly add to the scholarly work that has been conducted on the general question of North Korea and the effectiveness of sanctions.

Thirdly, this paper will contribute to understanding of the use of coercive diplomacy towards North Korea. It will supplement academic debate by investigating (1) the role of factious government and divergent objectives when implementing a measure and (2) the role of allied cooperation in influencing all aspects of coercer strategy. Applying a coercive diplomacy framework to the BDA sanction potentially expands upon the scholarly debate on the use of financial sanctions on rogue states. Not only will this research make contributions by summarizing historical detail and highlighting descriptive inference, but it will also be useful in evaluating causal inference as it applies its results to a theoretical framework that will help better understand the variables for successful sanction implementation.

With the United States currently imposing measures on fifteen countries, ranging from Belarus to North Korea, and having implemented ‘reputational sanctions’ on Iranian and North Korean banks once again, research that can help develop the understanding of how such measures achieve their stated purpose is essential and can have real-world as well as academic implications.⁶⁴

⁶⁴ US Department of the Treasury, Resource Center, Financial Sanctions, at <http://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx>, (retrieved 12/05/2011).

Chapter IV

Descriptive Analysis:

BDA Affair's Key Events

This chapter depicts the major chronological events that surround the BDA affair and focuses on the actions of the four major states, US, China, South Korea and North Korea, at particular points in time, ranging from events prior to the BDA's implementation to its retraction. Following a description of the setting within which the sanction was implemented, the affair is broken down into seven parts that show the course of events from the imposition of the BDA to its eventual withdrawal.

4.1 Before Sept 2005: Pre-BDA Setting

The governments, policies and actions taken by the US, China, South Korea and North Korea prior to the implementation of the BDA sanction contrasted greatly. The fundamental political backgrounds of Seoul's progressive leader of the Uri Party, Roh Moo hyun, China's Hu Jintao, North Korea's Kim Jong-Il and the United State's republican, George W. Bush were not easily coordinated because priorities, approaches and objectives differed. Therefore, 2005 effectively saw little progress in resolving the North Korean nuclear issue and with the issues of human rights and criminal activities added to the agenda by a hardened George Bush policy team, the situation actually became more complex. Overall relationships and regional trends saw no major reversals or breakthroughs.⁶⁵

⁶⁵ Emma Chanlett-Avery, et. al, *North Korea: A Chronology of Events in 2005*, p. 24.

In South Korea, the BDA sanction and its fallout took place under the tenure of President Roh Moo hyun, who had been elected in December 2002 upon a wave of youth support. Roh was from the so called '386 generation' that had been veterans of student protests against authoritarian rule and advocated a conciliatory approach towards North Korea, even at the expense of good relations with the US.⁶⁶ His administration sought, under their 'Peace and Prosperity Policy,' to continue the 'Sunshine Policy' of his predecessor Kim Dae-Jung and encourage positive internal change within North Korea through 'reconciliation, cooperation, and the establishment of peace.'⁶⁷ Kim Dae jung had recognized that even a 'soft collapse' along the lines of German reunification, would impose huge, perhaps calamitous, economic and social costs on the ROK and an actual full-blown war would be disastrous with estimates of one million casualties.⁶⁸ Therefore, the Roh extension of his policy was another attempt at defusing tension and economic cooperation as a way of leading to eventual measured and consensual reunification.

At this time, China had three principle concerns with regards to the DPRK. First, it feared that an escalation of tension would derail Chinese surging economic growth. Second, that a nuclear-armed North Korea would give encouragement, or an excuse, for the nuclearization of an already remilitarizing Japan.⁶⁹ Third, that the possible collapse of the DPRK could send a flood of refugees into China. With a view to tackle such concerns, the Six-Party Talks, first engineered Colin Powel and the US,

⁶⁶ B.J. Lee, South Korea: Too Much Activism, *Newsweek*, 27 November 2006, at <http://www.newsweek.com/2006/11/26/south-korea-too-much-activism.html>, (retrieved 24/02/2012).

⁶⁷ Tae-Hwan Kwak and Seung-Ho Joo, *The Korean Peace Process and the Four Power*, Hampshire, England: Ashgate, (2003), p. 12.

⁶⁸ Kim Dae Jung, 'Sunshine Policy Still Valid: Kim Dae-jung,' *Nihon Keizai Shinbum*, 26 March 2004. And, Donald Macintyre, 'Kim's war machine,' *Time Asia*, February 24, 2003.

⁶⁹ Jin Ryu, 'S. Korea, Japan Need Nukes,' *Korea Times*, December 24, 2004.

and later accepted by China, were an attempt to reconcile the DPRK's desire for bilateral negotiations with the US with the latter's strategy of applying pressure both directly and through the regional powers, so that North Korea could be forced to abandon its nuclear program.

Augmenting this, economic support was being given to the DPRK by China. Though a rehabilitation of the DPRK economy would facilitate its burgeoning economic ties with South Korea and whilst the economic (and political) reunification of the peninsula under South Korean hegemony would have its own drawbacks, these are minor compared with the status quo, with the collapse of the DPRK or, worst of all, with war.⁷⁰ So strong were their economic links that the US believed that China was actually supplying North Korea with an estimated 90% of its oil and 40% of its food and in 2005, their trade level even increased to a new high of \$1,581.234.⁷¹

China did accept US intelligence that North Koreans had a uranium enrichment program but rather than apply pressure on Pyongyang, explained to representatives from the DPRK, that it was aware of the program, but did not deem it to be a matter of concern.⁷² In fact, in May 2005, Yang Xiyu, a senior Foreign Ministry official and China's top official on the North Korean nuclear problem accused the Bush administration of undermining efforts to revive negotiations with the North Korean government and said there was 'no solid evidence' that North Korea was preparing to test a nuclear weapon. This reflected growing frustration in Beijing with the Bush administration and blamed 'the lack of cooperation from the US side' for the lack of

⁷⁰ Timothy Beal, *Discordant Beijing Sextet Plays in Harmony: but for How Long?* *Journal of Asian Studies* 7, 2 (December, 2005), p. 82.

⁷¹ Emma Chanlett-Avery, et. al, *North Korea: A Chronology of Events in 2005*, CRS Report RL33389 April 24, 2006, Congressional Research Service, Washington, DC, (2006), p. 5.

⁷² Sakajiri Nobuyoshi, *China Now in Sync with U.S. on N. Korea*, *Asahi Shimbun*, February 28, 2005.

progress on denuclearization.⁷³ Thus showing that, the Chinese policy was closer to that of South Korea than the US and that it prioritized the maintenance of stability on the peninsula over other issues.

The DPRK consistently called for the United States to end its ‘hostile policy’ and drew up two preconditions for their return to Six-Party Talks. As the North Korean envoy to the United Nations, Deputy Ambassador Han Song ryol said a return to talks was possible if the US ‘can promise coexistence and noninterference’ and ‘makes us believe that we can expect concrete results from these talks.’ He added, ‘If the United States withdraws its hostile policy, we will drop our anti-Americanism and befriend it. Then why would we need nuclear weapons?’⁷⁴ Such rhetoric however, was largely ignored by the US.

In Washington, January 20th saw President George W. Bush Jr. commence his second term in the Whitehouse and denuclearisation was still the key goal as he looked set to continue a policy to nullify the ‘traditional, irregular and catastrophic threats’ posed by North Korea.⁷⁵ The main elements of Bush Administration policy were: (1) demanding that North Korea totally dismantle its nuclear programs; (2) withholding any US reciprocal actions until North Korea takes visible steps to dismantle its nuclear programs; (3) assembling an international coalition to apply pressure on North Korea in multilateral talks; and (4) planning for future economic

⁷³ Joseph Kahn, China Says U.S. Impeded North Korea Arms Talks, *New York Times* May 13, 2005, p. A-1.

⁷⁴ Alexa Olesen, Report: North Korea Doesn’t Want U.S. Talks, Associated Press, February 19, 2005.

⁷⁵ Department of Defense, United States of America, National Defense Strategy of the United States of America, March 2005, at <http://www.defense.gov/news/mar2005/d20050318nds1.pdf>, (retrieved 13/1/2012), p. 2-4. Traditional challenges are most often associated with states employing armies, navies, and air forces in long-established forms of military competition. Irregular challenges reflect adversaries employing irregular methods such as insurgency and terrorism with an aim to erode US influence, patience, and political will. Catastrophic challenges come in the form of a state acquiring catastrophic capabilities such as weapons of mass destruction.

sanctions and military interdiction against North Korea. China organized Six-Party Talks in mid-2003, but the talks made little progress.⁷⁶ Differences between the Bush Administration and South Korea over policies toward North Korea were evident. South Korea emphasized bilateral reconciliation while the US sought to coerce Pyongyang into giving up its nuclear ambitions.

The Bush Administration's policy toward North Korea was based on two factors within the Administration. First, President Bush had voiced distrust of North Korea and its leader, Kim Jong il. Second, there were divisions within the Administration over policy toward North Korea. An influential coalition consisting of Secretary of Defense Rumsfeld and his advisers, Vice President Cheney and his advisers, and proliferation experts in the State Department and White House led by Under Secretary of State John Bolton opposed negotiations with North Korea, favored the issuance of demands for unilateral North Korean concessions on military issues, and advocated isolating North Korea diplomatically and through economic sanctions. This faction expressed the hope and/or expectations of a collapse of the North Korean regime. A second group, made up of officials in the State Department and White House with experience on East Asian and Korean issues, favored negotiations before adopting more coercive sanctions; they doubted the effectiveness of a strategy to bring about a North Korean collapse.⁷⁷

After a first term in which the US had not compromised on its demand for 'complete, verifiable, and irreversible dismantlement (CVID)' and labeled North Korea part of the 'axis of evil,' some early changes at the beginning of the second suggested a possible softening of the US position. US Ambassador to South Korea

⁷⁶ Larry A. Niksch, *Korea-US Relations: Issues for Congress*, CRS Report RL33567, (Feb, 22, 2008).

⁷⁷ Ibid.

Christopher Hill, a career foreign service officer with a reputation as a strong negotiator, was selected to be Assistant Secretary for East Asia and the Pacific, as well as the chief envoy for the Six-Party Talks and Condoleezza Rice was confirmed as Secretary of State. As Rice began her post at the State Department, policy analysts studied her language for clues about the US approach to North Korea. During her confirmation hearing, she included North Korea among the list of 'outposts of tyranny,' thereby appearing to signal a tough approach to the North. However, her declaration during a March swing through Asia that North Korea was a 'sovereign state' was interpreted as a willingness to negotiate with Pyongyang. Apparently operating with more authority than his predecessor, Hill engaged the North Koreans in bilateral meetings and, eventually, in the Six-Party Talks.⁷⁸

However, President Bush's State of The Union Address on the 31st January 2006, though less aggressive than in the past, still outlined 'the end of tyranny'⁷⁹ as the goal of the United States and two figures that appeared later in the year, were seen by many in the policy community as delivering a more hardline message to the North Koreans: Alexander Vershbow, the incoming US Ambassador to South Korea, and Jay Lefkowitz, Special Envoy for Human Rights in North Korea. The US policy was thus unclear and its approach inconsistent. Thus, despite suggestions of a partial softening, the Roh and Bush governments had very different plans with which to deal with a North Korea.

The four countries thus had differing positions, priorities and approaches to the North Korean issue that meant progress on the one coordinated aspect of policy – Six-

⁷⁸ Emma Chanlett-Avery, et. al, *North Korea: A Chronology of Events in 2005*, p. 36.

⁷⁹ FDCH E-Media, Text of President Bush's 2005 State of the Union Address, *The Washington Post*, Feb. 2, 2005, at http://www.washingtonpost.com/wp-srv/politics/transcripts/bushtext_020205.html, (retrieved 3/12/2011).

Party Talks, was proving very difficult.

4.2 Stage 1: Sept 2005 - BDA Implementation

In such a setting, it was on September 15 2005, that the US Treasury Financial Crimes Enforcement Network (FinCEN), as part of a broad crackdown on North Korean criminality, designated BDA a ‘primary money laundering concern.’⁸⁰ The initiation of the sanction coincided with the first major breakthrough of the Six-Party Talks, the September 19, 2005 Joint Statement of Principles, the so-called 9.19 Agreement, in which North Korea agreed to dismantle its nuclear weapons programs in exchange for economic and other compensation.⁸¹

The sanction initially made little news in South Korea as the government continued to believe that it had ‘succeeded in adopting the Joint Statement and initiating the implementation negotiation’ and that they would ‘continue to expand economic cooperation and promote various humanitarian projects’ as ‘the Six-Party Talks process as a whole has entered the critical phase of substantive resolution of the North Korean nuclear issue.’ On the BDA sanction, South Korea assumed the same position as that of the United States stating that it viewed the issue as being ‘related to law enforcement,’ and that ‘it should not be an obstacle which would hinder the Six-Party Talks process.’⁸² Seemingly attempting to downplay the sanction, South Korea chose to deliberately focus upon the resumption of talks and tried to gloss over the

⁸⁰ For a comprehensive listing of North Korea’s alleged criminal activities, see Sheena E. Chestnut, “The Soprano State?” North Korean Involvement in Criminal Activity and Implications for International Security, *Stanford University* (20 May, 2005) and David, L. Asher, “The North Korean Criminal State, its Ties to Organized Crime and the Possibility of WMD Proliferation, *Northeast Asia Peace and Security Network Policy Forum Online*, (November 15, 2005). And, Treasury Department, US Government, Federal Register/Vol. 70, No. 181/Tuesday, September 20, 2005.

⁸¹ United States Department of State, Joint Statement of the Fourth Round of the Six-Party Talks, Beijing 19 September 2005, (September 2005).

⁸² Remarks by H.E. Ban Ki-moon at a Luncheon in Honor of the Ambassadors of the Member States of the EU & EFTA, December 20, 2005, at <http://www.mofat.go.kr/english/help/search/index.jsp>, (retrieved 17/11/2011).

dollar-counterfeiting issue by claiming it to be a crime linked to North Korean organizations rather than the Kim Jong il regime itself.⁸³

Seoul simply continued its efforts to engage with North Korea and aid its economy. For example, South Korean Finance Minister Han Duck soo, on a visit to Washington reportedly stated that North Korea should be encouraged to join IMF and World Bank. Korea Resources Corp (KORES) stated that it aimed to open an office in Pyongyang and the first inter-Korean company, Korea's Andong Hemp and North South Korea's Saebyol Pyongyang Hemp Textile Company, was inaugurated in Pyongyang. At the same time, over 4,000 South Korean tourists traveled to North Korea's Arirang mass games, which previously were off limits, many by daily charter flights from Seoul to Pyongyang. Politically as well, a South Korean presidential panel, chaired by President Roh, said that Seoul should take the lead in resolving the North's nuclear issue and developing the Six-Party Talks into a regional northeast Asian community and a 'multilateral security-economy entity.'⁸⁴ These events take place over an eight-day period from September 23 to October 1, 2005, just two to three weeks after the implementation of the BDA sanction and show that to Seoul, regardless of the sanction, it was business as usual as they pursued their original policies.

In China the sanction was welcomed and did not seemingly affect the PRC-DPRK relationship as an economic agreement was promised and signed in the following October.⁸⁵ More significantly, in the first visit by a Chinese leader since

⁸³ Chosun Ilbo, Seoul Maneuvers Itself to the Sidelines on N. Korea, January 24, 2006, at http://english.chosun.com/site/data/html_dir/2006/01/24/2006012461033.html, (retrieved 21/11/2011).

⁸⁴ Emma Chanlett-Avery, et. al, *North Korea: A Chronology of Events in 2005*, p. 38.

⁸⁵ Shirley A. Kan, *China and Proliferation of WMD and Missiles*, Congressional Research Service Report, November 15, 2006, p. 28.

2001, President Hu Jintao visited North Korea and met Kim Jong il. Kim noted that he was committed to ending the North's nuclear weapons program and that he would push forward with multinational negotiations on the matter soon. In return, President Hu promised to provide aid to neighboring North Korea's struggling economy 'within China's means' and reportedly committed \$2 billion.⁸⁶ This agreement highlighted the consolidation of strong political and economic relations between the two nations.

In the United States, however, the news of the sanction was divisive. Some noted that this was not a surprise sanction as since early 2005 the Bush administration had formed a classified 'tool kit', thought to be sanctions, that would be used as part of a new strategy to intensify and coordinate efforts to track and freeze financial transactions that enabled the government of Kim Jong il to profit from counterfeiting, drug trafficking and the sale of missile and other weapons technology.⁸⁷ The Treasury had already used such a tool in June 2005 when it implemented Executive Order 13382 and seized the assets of three North Korean entities 'responsible for WMD and missile programs,' and barred U.S. citizens and companies from doing business them.⁸⁸ Others however, most especially within the State Department had not expected such a sanction to be implemented.

Rifts within the administration had been evident even prior to the BDA, in the drafting of the 9.19 Agreement, reflected in Hill's suspicion that 'wordsmithing' by Victor Cha, Robert Joseph, and the National Security Council Non-Proliferation Chief John Rood, as they called for last minute changes to the wording of a document that he believed they 'basically didn't want an agreement.' The contents of the unilateral

⁸⁶ Emma Chanlett-Avery, et. al, *North Korea: A Chronology of Events in 2005*, p. 40.

⁸⁷ David Sanger, U.S. Is Shaping Plan to Pressure North Koreans, *New York Times*, February 14, 2005.

⁸⁸ US Department of the Treasury Office of Foreign Assets Control, Executive Order 13382 of June 28, 2005, Blocking Property of Weapons of Mass Destruction Proliferators and Their Supporters, <http://www.treasury.gov/resource-center/sanctions/Programs/Documents/wmd.pdf>, (retrieved 04/04/2012).

declaration, read by Hill but crafted by the same three men, also differed in tone and substance as it called for North Korea to ‘completely, verifiably and irreversibly’ end all nuclear programs. Hill again noted that this amounted to a hardliner manifesto that was ‘impolite, rude and deliberately designed to goad the North Koreans.’⁸⁹ Such observers as Leon Sigal alleged that hardline unilateralists in the administration led by Vice President Dick Cheney, effectively undid the agreement and hamstrung US negotiators.

At the Treasury, Bob Joseph, who had championed the BDA, was a figure that at this time was described by John Bolton to have felt ‘isolated’ and unhappy that Secretary Rice ‘was listening to Hill on North Korea...and certainly not to him.’⁹⁰ Likewise, David Asher gave a speech support BDA noting, ‘In essence, North Korea has become a ‘soprano state’ and advocated a policy of ‘comprehensive diplomatic isolation.’⁹¹ Subsequent decisions to terminate the Korean Peninsula Energy Development Organization (KEDO) and to issue such statements as the ‘appropriate time’ for discussion was ‘when hell freezes over,’ by Secretary Rice, seemed to indicate a deliberate attempt to undermine the progress made by the talks.⁹²

Pragmatists such as Hill were upset by such hardliner-led moves and noted that America was ‘the victim’ of efforts to ‘tighten the noose’ on North Korea, blaming ‘Washington politics’ for the incident as ‘hardliners grabbed North Korean policy reins.’⁹³ It was also claimed by an administration insider that ‘the neo-cons seized on BDA as ‘someone leaked it (the story) to discredit the other track of the negotiation

⁸⁹ Chinoy. *Meltdown*, pp. 249-250.

⁹⁰ John Bolton, 2008, *Surrender Is Not an Option: Defending America at the United Nations*, (New York: Threshold Editions), p. 321.

⁹¹ David Asher, 2005. The North Korean Criminal State, its Ties to Organized Crime, and the Possibility of WMD Proliferation, *Remarks to the Counter-Proliferation Strategy Group, Woodrow Wilson Center*, November 15th, 2005.

⁹² Leon V. Sigal, An Instinct for the Capillaries, *Policy Forum Online* 06-36A: May 9th, 2006.

⁹³ Guy Dinmore and Anna Fifield US hardliners grab N Korea policy reins, *Financial Times*, December 19 2005, at <http://www.ft.com/intl/cms/s/0/6d37c530-70c8-11da-89d3-0000779e2340.html#axzz1PmkY1spn>, (retrieved 14/06/2011).

(9.19 Agreement).⁹⁴ He was said to have been furious with the timing of the sanction but adamant that he needed to deal with this issue in order to preserve his own credibility and maintain his negotiating leeway. Ultimately, despite the setback, he hoped to progress with talks regardless. As more hardliner elements of the administration sought to use more critical rhetoric, pragmatists, though antagonized by the sanction sought the maintenance of engagement. However, the full extent of the BDA sanction was not yet known.

4.3 Stage 2: 9.19 Agreement

Despite official declarations that they shared the same goal of eliminating North Korea's nuclear weapons program through a diplomatic process, relations up until September 2005 between Washington, Seoul and Beijing were often strained by their different approaches. The Roh Administration's public embrace of a framework aimed at 'balancing' the nuclear issue with North-South reconciliation and China's support of a non-coercive approach to North Korea that was sometimes at odds with stated US goals. However, despite the lack of commonality between the United States and its allies with regards to its coercive approach to North Korea, enough diplomatic coordination was established in order for an agreement to be signed on September 19 2005.

The Joint Agreement signed by all the Six-Party Talks members saw North Korea commit to ending its pursuit of nuclear weapons, rejoin the Nuclear Nonproliferation Treaty, and readmit IAEA inspectors. In exchange, the other signatory states would provide North Korea with new security commitments and aid - including electricity from South Korea. Longer-term commitments included the

⁹⁴ Chinoy. *Meltdown*, p. 259.

United States taking steps to normalize its relations with North Korea, and all signatories would consider taking steps to provide a light-water reactor to that country. The six parties agreed to take coordinated steps to implement the aforementioned consensus in a phased manner in line with the principle of ‘commitment for commitment, action for action.’⁹⁵ However, no timeline or sequence of events had been drawn up on detailed implementation of the plans. This was supposed to be established in a subsequent meeting, to be held the following November.⁹⁶ The Joint Statement expressed the willingness of the United States to respect the DPRK’s sovereignty and to exist with the DPRK peacefully together, but it warned that there were outstanding issues, including human rights abuses, biological and chemical weapons programs, ballistic missile programs and proliferation, terrorism, and most importantly to this paper, illicit activities.⁹⁷

The ROK President Roh Moo hyun welcomed the joint statement calling it an ‘epoch-making’ one, which formulated ‘principles’ for the ending of the nuclear issue. Local business sectors hailed the joint statement as ‘a great achievement,’ expressing their excitement over the possible benefits that it could have on their business activities. Unification Minister Chung Dong young lauded the compromise settlement reached at the Six-Party Talks as ‘a victory of South Korea’s diplomacy, launching the initial step toward resolving the Cold War structure on the Korean Peninsula and building a permanent peace structure in Northeast Asia.’⁹⁸ ROK negotiator Song Min soon also attested to the ‘outstanding’ role played by China in

⁹⁵ United States Department of State, Joint Statement of the Fourth Round of the Six-Party Talks, Beijing 19 September 2005, (September 2005).

⁹⁶ Ibid.

⁹⁷ Ibid.

⁹⁸ Editorial, Seoul Saved Six-Party Talks: Unification Minister, *Chosun Ilbo*, September 19, 2005, at http://english.chosun.com/site/data/html_dir/2005/09/19/2005091961024.html, (retrieved 23.02,2012).

forging an agreement between the member-states.⁹⁹ Chairing the talks, Vice Foreign Minister Wu Dawei, Beijing's envoy, noted 'this is the most important result since the Six-Party Talks started more than two years ago.'¹⁰⁰

The supposed change of US approach was primarily led by Christopher Hill, but was augmented by statements made both by Secretary Rice and President Bush. The Bush administration effectively overhauled the substance and the style of its approach to North Korea as officials stopped using the accusatory language President Bush once used when he called North Korea a member of the 'axis of evil.' More specifically, Rice noted, in a speech in Sophia University that "no one denies that North Korea is a sovereign state' and that 'we have said repeatedly that we have no intentions of attacking or invading North Korea.'¹⁰¹ Furthermore, George Bush, so scathing of the North Korean leader in previous speeches, publicly referred to him as 'Mr. Kim Jong il,' rather than 'dictator in November 2005.' The agreement appeared to boost support for people inside the Bush administration who favored pursuing laborious negotiations with the North Koreans. The position of hardliners in the administration and in Congress that had raised questions about the usefulness of negotiations with the North, which they argued had no intention of abandoning its nuclear weapons were weakened by the signing of the agreement.

America had managed to work closely with South Korea and China to address the North's security and economic concerns and reassured the North that the United States recognized it as sovereign. Officials relaxed their stand on the North retaining

⁹⁹ Xinhua News, ROK chief negotiator: China's role "outstanding", *Xinhua News*, September 19, 2005, at http://news.xinhuanet.com/english/2005-09/19/content_3513291.htm, (retrieved 23.02.2012).

¹⁰⁰ Associated Press, North Korea Pledges to Give Up Nuclear Weapons Program, *New York Times*, September 19, 2005.

¹⁰¹ Bonnie S. Glaser, U.S.-China Relations: Rice Seeks to Caution, Cajole, and Cooperate with Beijing, Secretary of State Condoleezza Rice, Remarks at Sophia University, (March 19, 2005), p. 31.

some kind of peaceful nuclear program, and offered the prospect of normalizing relations with country. Ultimately, though the agreement still faced hurdles, including the degree of intrusiveness of inspections in the closed North Korean state, as well as to scope and nature of any peaceful nuclear program the North is allowed to retain, it was a significant step towards denuclearization.¹⁰² However, there was seemingly progress and such steps were welcomed by both China and South Korea.

4.4 Stage 3: Oct - Dec 2005 - North Korean Linkage

As early as November 5, at the fifth round of the Six-Party Talks in Beijing, where the North Korean delegation focused almost exclusively on the BDA frozen funds, it was apparent that the sanction had become a difficult issue.¹⁰³ However, it was the following month, on December 18, when Pyongyang, by indefinitely suspending the Six-Party Talks until US sanctions against North Korean companies were lifted, that it became abundantly clear that North Korea was linking the sanction to the issue of denuclearization. North Korea called for the US to ‘lift its sanctions against the DPRK, the main factor of scuttling the talks’ and labeled them as a ‘wanton violation and distortion of the joint statement.’¹⁰⁴ The government also directly stated that the DPRK ‘cannot sit down and discuss abandonment of our nuclear deterrent designed to protect our system with a counterpart that seeks to isolate and stifle us to death.’¹⁰⁵ A Foreign Ministry spokesman plainly outlined their position that ‘the financial

¹⁰² Joseph Kahn, North Korea Says It Will Abandon Nuclear Efforts, *New York Times*, September 19, 2005.

¹⁰³ Kimball and Crail, Chronology of US-North Korean Nuclear and Missile Diplomacy, Arms Control Association.

¹⁰⁴ Rodong Sinmun signed commentary, Korean Central News Agency, US Urged to Fulfill Its Commitments before Calling for Resumption of Six-Party Talks, *Rodong Sinmun*, on January 3, 2006.

¹⁰⁵ Seo Dong-shin, N.K. Threatens to Boycott Nuke Talks, *Rodong Sinmun*, January 3, 2006.

sanctions against the DPRK are an issue directly related to the Six-Party Talks.’¹⁰⁶

At this point support from the South Korean government weakened, as the BDA sanction began to impede the ‘forward momentum’ needed for progress to be ‘maintained on inter-Korean relations and the Six-Party Talks.’¹⁰⁷ Requests made by Daniel Glaser, Deputy Assistant Treasury Secretary for Terrorist Financing and Financial Crimes, for Seoul to impose financial sanctions fell on deaf ears as Foreign Minister, and Ban Ki moon remained non-committal and even slammed the reporting of the request as ‘inappropriate’ claiming that, ‘formally or informally, there had been no urging of our government to adopt concrete sanctions.’¹⁰⁸ Then, ROK Defence Minister, Yoon Kwang ung aggravated Washington by opposing any expansion of South’s military operations outside the peninsula because it could trigger instability and an arms race in East Asia.¹⁰⁹ As the US sought to further pressure North Korea, Ban then casts doubt on the BDA evidence, labelling it ‘inconclusive.’¹¹⁰ Promised by PRC Vice PM Wu Yi and later signed by President Hu Jintao, the Chinese adopted a business-as-usual approach and signed a comprehensive economic agreement with the DPRK and did not state any opposition or negative comments with regards to the BDA.

Some within the Bush administration tried to defend the sanction and isolate it from other policy tracks related to the DPRK. For example, those in the Treasury

¹⁰⁶ Korean Central News Agency, DPRK Foreign Ministry’s Spokesman Urges US to Lift Financial Sanctions against DPRK, January 9, 2006, at <http://www.kcna.co.jp/item/2006/200601/news01/10.htm>, (retrieved 19/11/2011).

¹⁰⁷ Remarks by H.E. Ban Ki-moon at a Luncheon in Honor of the Ambassadors of the Member States of the EU & EFTA, December 20, 2005.

¹⁰⁸ Chosun Digital, US Urges Seoul to Match N. Korea Sanctions, *Chosun Ilbo*, January 24, 2006. And, Chosun Digital, Seoul Raps US Mission Over N.K. Sanctions Bombshell, *Chosun Ilbo*, January 25, 2006, at http://english.chosun.com/site/data/html_dir/2006/01/25/2006012561015.html, (retrieved 20/11/2011).

¹⁰⁹ Editorial, Yoon Opposes Military’s Expanded Role Abroad, *Korea Herald*, January 23, 2006.

¹¹⁰ Brian Lee, Ban Ducks on Bogus Cash, North, *JoongAng Ilbo*, January 25, 2006.

claimed that the BDA sanctions ‘were necessary for our defense and the defense of our friends and allies,’ and that they were “independent of the diplomatic efforts that we are pursuing.’ Christopher Hill also noted that the BDA sanction was what ‘we’d call defensive sanctions’ and that he had ‘nothing to do with it” as they ‘are quite separate from the issue of Six-Party Talks’¹¹¹ claiming it ‘was not coordinated.’¹¹² Other like David Asher explained that it was an issue related to law, an ‘initiative with the goal of countering these (illegal) activities themselves and the people that are involved with them, not necessarily just supporting the Six-Party Talks.’¹¹³ He also later stated, ‘the timing was just a coincidence.’¹¹⁴ Aaron L. Friedberg, former Deputy National Security Advisor for Vice President Dick Cheney also noted that the sanctions were not ‘synchronized’ so as to ‘get them (the State Department) to agree to something in principle and then slam them a few days later.’¹¹⁵ Despite such claims that sabotage had not been the motive in implementing the sanction, some noted that it was the rise of the hardliners that had derailed talks.¹¹⁶

However, others indicated the broader objectives and hopes for the BDA sanction so it was not without justified cause that the DPRK linked the two policy tracks. For example, even officials in the White House such as spokesman Scott

¹¹¹ Carol Giacomo, N. Korea Hints at Curbing Money Laundering, *Reuters*, (January 25, 2006), at http://www.redorbit.com/news/international/370145/nkorea_hints_at_curbing_money_laundering, (retrieved 2011/11/28).

¹¹² Ambassador Christopher Hill, Assistant Secretary of State for East Asian and Pacific Affairs, Keynote Address, at AEI Conference, Sustaining the Alliance, (February 1, 2006), at <http://www.aei.org/events/print/sustaining-the-alliance-event>, (retrieved 21/11/2011).

¹¹³ Asher, L. David, Statement at the Hearing before the House Foreign Affairs Subcommittee on Terrorism, Nonproliferation, and Trade & The House Financial Services Subcommittee on Domestic and International Monetary Policy, Trade, and Technology, *Isolating Proliferators and Sponsors of Terror: The Use of Sanctions and the International Financial System to Change Regime Behavior*, (April 18, 2007).

¹¹⁴ Martin Fackler, North Korean Counterfeiting Complicates Nuclear Crisis, *New York Times*, January 29, 2006, p. 3.

¹¹⁵ Aaron L. Friedberg, Only Continued Pressure, Combined With Inducements, Can Bring End to North Korean, *Council on Foreign Relations Interview*, February 21, 2006, at <http://www.cfr.org/north-korea/friedberg-only-continued-pressure-combined-inducements-can-bring-end-north-korean-nuclear-program/p9915>, (retrieved 25/11/2011).

¹¹⁶ Glenn Kessler, Diplomats Labor to Renew Talks with N. Korea, *Washington Post*, February 5, 2006, p. A-18

McClellan connected the BDA to denuclearization. He noted that it would be ‘complementary to our continued diplomatic efforts’ and that it would not allow North Korea to ‘continue its involvement in illegal activities’ and so ‘It must make a strategic decision and eliminate its nuclear weapons program.’¹¹⁷ As well as this, Bob Joseph also explained that he hoped that it would ‘reinforce the prospect for the success of those talks’¹¹⁸ and later revealed a more hardliner objective as he claimed that in North Korea ‘we need to see transformation. It’s not just the nuclear issue. It’s a brittle regime. It’s an argument for not throwing them a lifeline.’¹¹⁹ There were clearly links between the sanction and denuclearization and it was evident that some of those who were charged with its implementation had objectives that spread beyond those related to finance. Thus deliberate US connection and perceived connection by North Korea meant that the goal of the policy was effectively broadened.

Though the goal of the BDA had been to damage the North Korean financial network, it was evident that it was affecting the denuclearization process. The Treasury had seemingly expected that the North Koreans would simply withdraw their cash from BDA’s account and not that the Macau Monetary Authority would freeze all the suspect accounts and enlarge the issue to the point that it would affect denuclearization.¹²⁰ But once it did so, it seems that hardliners in the Treasury, ultimately aiming for a ‘transformation,’ believed the sanction could benefit this goal, and thus it became a coercer tool whose objective was clearly broader. Showing that the BDA sanction was not to be the only sanction the Treasury would implement, on October 21, 2005, building upon Executive Order 13382 that had been issued in June

¹¹⁷ David E. Sanger, U.S. Is Shaping Plan to Pressure North Koreans, *New York Times*, February 14, 2005.

¹¹⁸ David E. Sanger, US Widens Campaign On North Korea, *New York Times*, October 24, 2005, at <http://www.nytimes.com/2005/10/24/international/asia/24korea.html>, (retrieved 14/06/2011).

¹¹⁹ Chinoy. *Meltdown*, p. 262.

¹²⁰ Ibid. p. 312.

2005, it announced that it had sanctioned eight North Korean entities pursuant to their unspecified ‘involvement’ in the proliferation of nuclear, chemical, or biological weapons or related delivery vehicles. This action also froze the entities’ U.S. assets and prohibited transactions between these entities and any U.S. citizens or companies.¹²¹

It seemed that Bob Joseph had succeeded in capturing the lead in North Korea policy as he did in the first term and that Christopher Hill was finding it difficult to rebound from events that began to slip out of his control beginning with the US statement of September 19, 2005.¹²² Bush’s second-term foreign policy was more in line with the old realist approach with Secretary of State Rice and her chief deputies, Robert Zoellick and Nicholas Burns, in favor of increased engagement with the U.N. and other multinational groups. However, it is clear that policy goals, perceptions and intentions within the administration were different and it was not purely North Korean misperception that linked the BDA sanction to denuclearization.¹²³

4.5 Stage 4: Jan 2006 – Hardened US Position

As the BDA affair continued, the US position on the sanction continued to harden as rhetoric became more aggressive and further actions were taken to augment the initial sanction. However, the effect of the sanction in stalling the Six-Party Talks was less welcome to regional allies.

¹²¹ US Department of the Treasury Office of Foreign Assets Control, Treasury Targets North Korea Entities for Supporting WMD Proliferation, October 21, 2005, at <http://usinfo.org/wf-archive/2005/051021/epf503.htm>, (retrieved 04/04/2012).

¹²² Charles L. Pritchard, Six Party Talks Update: False Start or a Case for Optimism? *Presented at The Changing Korean Peninsula and the Future of East Asia Co-hosted by Center for Northeast Asian Policy Studies*, The Brookings Institution Seoul Forum of International Affairs, JoongAng Ilbo, December 1, 2005, at <http://www.brookings.edu/fp/cnaps/events/20051201presentation.pdf>, p. 10.

¹²³ Jay Solomon and Neil King, Jr., “As ‘Neocons’ Leave, Bush Foreign Policy Takes Softer Line,” *Wall Street Journal*, February 6, 2006, at http://cactus.dixie.edu/green/B_Readings/Solomon%20&%20King%20NeoCon%20Demise.pdf, (retrieved 22/11/2011).

In South Korea, the reaction to the BDA post DPRK linkage was growing negative. It accepted that it should and would cooperate with international efforts against all financial crimes, but did not respond specifically to the U.S. allegations about North Korea.¹²⁴ President Roh, at a news conference, even stipulated that ‘the South Korean government does not agree with certain opinions in the United States, which apparently are trying to pressure North Korea’ and that the ‘full truth’ regarding the action needed to be ascertained.¹²⁵ Even former President Kim Dae-Jung noted that the US had not ‘secured any direct evidence of the North’s alleged counterfeiting,’¹²⁶ There was clearly a conflicting approach, as while South Korea was withdrawing support for the action, President Bush was more vehemently stressing that ‘we are going to uphold the law and protect the currency of the American people.’¹²⁷ With regards to illicit activities that Seoul considered to be ‘nothing new,’¹²⁸ its position became distant from that of the United States, and even in February 2006, five legislators led by Rep. Lim Chae jung of the Uri Party met Supreme Assembly leader Kim Yong nam and, claiming North Korean willingness, advocated a bilateral North-South resolution to the issue.¹²⁹

News that the South Korean government was not cooperating fully with the US by withholding information with regards to supernotes in circulation in South

¹²⁴ Chosun Ilbo, China Says Counterfeiting Allegations Holding Up North Korea Nuclear Talks, at http://english.chosun.com/site/data/html_dir/2006/01/25/2006012561034.html, (retrieved 20/11/2011).

¹²⁵ Yoo Cheong mo, Seoul Opposes Any US Move to Topple N.K. Regime, *Yonhap News*, January 25, 2006.

¹²⁶ Lee Jong heon, Analysis: S. Korea’s Kim Eyes North Visit, *UPI*, February 2, 2006, at http://www.upi.com/Business_News/Security-Industry/2006/02/02/Analysis-SKoreas-Kim-eyes-North-visit/UPI-24371138895819/, (retrieved 19/11/2011).

¹²⁷ George W. Bush, White House, Office of the Press Secretary, Press Conference of the President, January 26, 2006.

¹²⁸ Chosun Ilbo, Seoul’s Man in US Condemns N. Korea’s Illegal Activities, February 8, 2006, (retrieved 20/11/2011).

¹²⁹ Annie I. Bang, N. Korea Seen Willing to Resolve Counterfeiting Issue: Lawmakers, *Korea Herald*, February 13, 2006.

Korea exemplified the growing rift between Washington and Seoul.¹³⁰ Some commentators in Seoul noted that, ‘the alliance has deteriorated to such an extent that it is difficult to see how it can be mended.’¹³¹ Regardless of the standoff between the US and the DPRK, South Korea continued work on the North-South railway, the Kaesong Industrial Complex and even sent shipments of hundreds of tons of fertilizer.^{132 133}

In China, though support for the BDA was still apparent, signs of its weakening were evident. Beijing had just completed their own three-month investigation of accusations that North Korea used a Macau bank to launder gains from currency forgery and confirmed suspicion of wrongdoing. It met with South Korea on the issue and pushed the DPRK to look into the matter.¹³⁴ In an unprecedented move The People's Bank of China even issued a directive to financial institutions there to increase vigilance against fake US\$100 bills that were being smuggled into the country.¹³⁵ At the same time, though such actions and investigations into banking irregularities of institutions linked to the DPRK continued, the Chinese Foreign Ministry spokesman, Kong Quan, said the charges were preventing a resumption of six-nation talks aimed at ending North Korea's nuclear programs. Their negativity towards the sanction, was however mild as he explained ‘China, as host,

¹³⁰ Chosun Ilbo, A Widening Rift between Seoul and Washington, February 13, 2006, (retrieved 20/11/2011).

¹³¹ Chosun Digital, A Blind Alley in the Korea-US Relationship, *Chosun Ilbo*, January 30, 2006, at http://english.chosun.com/site/data/html_dir/2006/01/30/2006013061016.html, (retrieved 20/11/2011).

¹³² Editorial, First Private Fertilizer Aid to Be Shipped to N. Korea This Week, *Yonhap News*, March 27, 2006.

¹³³ Kim, Suk Hi, Terence Roehrig, Bernhard Seliger, 2011, *The Survival of North Korea: Essays on Strategy, Economics and International Relations*, (North Carolina: Macfarland & Company), pp. 89-90.

¹³⁴ Chosun Digital, China Finds N.Korea Guilty of Money Laundering, *Chosun Ilbo*, January 11, 2006, at http://english.chosun.com/site/data/html_dir/2006/01/11/2006011161019.html, (retrieved 20/11/2011).

¹³⁵ Chosun Ilbo, China Cracks Down on Trade in Counterfeit Dollars, (3/19/2006), at http://english.chosun.com/site/data/html_dir/2006/03/19/2006031961006.html, (retrieved 20/11/2011).

has continuously and actively mediated to urge North Korea and the U.S. to consult to find an appropriate solution.’¹³⁶

As the affair started to gain media attention, both American and North Korea rhetoric began to intensify. In November, responding to a question at a roundtable of young leaders in Brazil, President Bush described the DPRK regime as ‘tyrants’¹³⁷ and prompted a sharp response from North Korea as it claimed that the remarks were ‘a blatant violation’ of the September Six-Party Talks agreement. Rhetoric from others also increased in severity as the US Ambassador to South Korea, Alexander Vershbow’s labeled North Korea’s leadership a ‘criminal regime’ and compared its acts of counterfeiting with those of the actions of the late German dictator Adolf Hitler.¹³⁸

As well as rhetoric, the Treasury Department, reflecting the resolve of the US government to maintain the sanction, on a visit to the ROK, stated that it had ‘nothing to do with the six party talks, and that it is purely a defensive law enforcement sanction to protect US financial institutions.’¹³⁹ As if to emphasize the legitimacy of this sanction, it actually took further action akin to that taken against the BDA. This came on March 30, 2006, when it was announced that it had imposed penalties on a Swiss company, along with one of its owners, for procuring ‘goods with weapons-related applications’ for North Korea.¹⁴⁰ This came at a time when figures within the

¹³⁶ Chosun Ilbo, China Says Counterfeiting Allegations Holding Up North Korea Nuclear Talks, at http://english.chosun.com/site/data/html_dir/2006/01/25/2006012561034.html, (retrieved 20/11/2011).

¹³⁷ George W. Bush, President Participates in Roundtable with Young Leaders in Brazil United States Embassy, Brasilia, Brazil, November 6, 2005, at <http://georgewbushwhitehouse.archives.gov/news/releases/2005/11/20051106.html>, (retrieved 20/11/2011).

¹³⁸ Jin Dae-woong, US envoy urged to refrain from hostile remarks on N.K., *The Korea Herald*, December 7, 2005, at <http://www.koreaherald.com/national/Detail.jsp?newsMLId=20051216000028>, (retrieved on 17/11/2011).

¹³⁹ Editorial, US Bank Probe Unrelated to Six-Party Talks, *Donga Ilbo*, January 24, 2006.

¹⁴⁰ U.S. Department of Treasury, —Swiss Company, Individual Designated by Treasury for

department like Under Secretary of the Treasury for Terrorism and Financial Intelligence, Stuart Levey were gloating that the sanction was having a ‘snowballing...avalanche effect,’ and labelled Hill – ‘Kim Jong hill’ when he made requests to be allowed debrief the North Koreans on the legalities of the action taken.¹⁴¹

President Bush, while never completely closing the door to talks, noted with conviction that ‘We are going to uphold the law and protect the currency of the American people.’¹⁴² This statement came at a time when the Bush administration had issued an updated national security strategy that reaffirmed preemption and stated that diplomacy with North Korea and Iran ‘must succeed if confrontation is to be avoided.’ National Security Advisor Stephen Hadley said that on proliferation and illicit activities ‘The North Korean regime needs to change these policies, open up its political system and afford freedom to its people.’¹⁴³ These threatening words signaled a hardening of Bush’s foreign policy strategy on both denuclearization and illicit activities.

In the Department of State there was at least some recognition of the need to resolve the BDA issue and acceptance that it was not an isolated policy. Spokesperson Adam Ereli’s indication during a press briefing that issues related to North Korea’s financial system could potentially be discussed in the six-party talks, showed recognition of the fact that the two policy tracks, financial sanctions and

Supporting North Korean WMD Proliferation, JS-4144, March 30, 2006.

¹⁴¹ Christian Caryl, Pocketbook Policing, *Newsweek*, at <http://www.thedailybeast.com/newsweek/2006/04/09/pocketbook-policing.html>, Apr 9, 2006, (retrieved 27/11/2011). And, Chinoy. *Meltdown*, p. 261.

¹⁴² President George W. Bush, White House, Office of the Press Secretary, Press Conference of the President, January 26, 2006.

¹⁴³ David E. Sanger, Report Backs Iraq Strike and Cites Iran Peril, *New York Times*, March 16, 2006, at <http://www.nytimes.com/2006/03/16/politics/16strategy.html?pagewanted=print>; and Deb Reichmann, Bush Reaffirms Preemptive Use of Force, *Associated Press*, March 16, 2006, at <http://archive.newsmax.com/archives/articles/2006/3/16/131922.shtml>, (retrieved 22/03/2012).

denuclearization had by now converged into one and were causing problems.¹⁴⁴ Those pragmatists, however, were now not leading policy.

It was clear that the BDA was working effectively in causing financial problems for the DPRK but that the sanction was actually much more expansive than planned and causing an ‘avalanche’. However, the increase in rhetoric, chastising of compromise-searching Hill, as well as reactions tantamount to gloating, reflected the hardening of the position on the BDA and suggests that the ‘hardliners had seized’ on the sanction.

4.6 Stage 5: July - Sept 2006 - DPRK Missile Tests

On July 4-5 2005 the DPRK fired a total of eight missiles over the Sea of Japan. Its spokesman emphasised North Korea had a ‘legitimate right as a sovereign state is neither bound to any international law nor to bilateral or multilateral agreements such as the DPRK-Japan Pyongyang Declaration and the joint statement of the six-party talks.’ These were agreements that it claimed the Bush administration had ‘scrapped’ and bilateral talks that it had ‘totally scuttled’. By the July 15, in response to this ‘threat to peace and security’, the United Nations Security Council adopted Resolution 1695 which ‘demanded’ the North to halt missile activities and ‘required’ member states to prevent transfer of missile technology to ‘all activities related to its ballistic missile program.’¹⁴⁵ As one US intelligence analyst noted ‘The North Koreans tried diplomacy first,’ only to have the U.S. go after their hard currency

¹⁴⁴ Adam Ereli, Deputy Spokesman, U.S. Department of State Daily Press Briefing, Daily Press Briefing Index, March 17, 2005, at <http://usinfo.org/wf-archive/2005/050317/epf402.htm>, (retrieved 03/04/2012).

¹⁴⁵ Resolution 1695, Security Council Condemns Democratic People’s Republic of Korea’s Missile Launches, United Nations Security Council, 15 July 2006, at <http://www.un.org/News/Press/docs/2006/sc8778.doc.htm>, (retrieved 22/10/2011).

accounts in Banco Delta Asia and elsewhere. ‘Then they went back to in-your-face.’¹⁴⁶

The South Korean government at this point became exasperated and called for the ‘winding up of the BDA.’ As one South Korean official put it, the Bush administration seemed to feel ‘it was more important not to have bilateral negotiations with North Korea than letting them get away with nuclear weapons. It was more important to crack down on their illicit activities than stopping them from building a nuclear arsenal.’¹⁴⁷ It was at this point that President Roh actually visited Washington and complained to President Bush requesting that the sanction be stopped. Interestingly, the American president later recollected, in an almost triumphant manner, that it ‘was the first time I thought we were really getting to the North Koreans’ and would not budge on the BDA.¹⁴⁸

However, the determination of the South Korean President was evident by the unprecedented meeting he held with the Chief of the Treasury, Henry Paulson, as he pushed for the sanction to be ended.¹⁴⁹ Moves by the South to unofficially resolve the BDA standoff were also made as ROK negotiator, Chun Yung-Woo, arranged what he jokingly called a ‘blind date’ for Hill to come to unofficially visit DPRK negotiator Kim Gye-Gwan. Hill refused to attend without Kim’s commitment to return to Six-Party Talks.¹⁵⁰ Again, the South Korea and American position stood in stark contrast, but this time their calls to end the sanction and their moves to solve it became louder and more assertive.

¹⁴⁶ Chinoy, *Meltdown*, p. 275.

¹⁴⁷ Ibid. pp. 288-89.

¹⁴⁸ Sanger, David E., 2009, *The Inheritance: The World Obama Confronts and the Challenges to American Power*, (New York: Harmony Books), p. 334.

¹⁴⁹ Chosun Digital, All Eyes on Roh’s Meeting With US Treasury Chief, *Chosun Ilbo*, September 12, 2006, at http://english.chosun.com/site/data/html_dir/2006/09/12/2006091261021.html, (retrieved 20/11/2011).

¹⁵⁰ Chinoy, *Meltdown*, p. 271-272.

China had cautioned North Korea not to proceed with a nuclear strike and warned of ‘grave consequences’ if it did so, but the DPRK defied Chinese wishes, and conducted the test, an action that Beijing described the act as ‘flagrant and brazen.’¹⁵¹ After the test China supported sanctions but joined South Korea in pushing for an end to the BDA.

Even within the US, positions on this event differed greatly as ‘trench warfare’ ensued in the Bush administration; hardliners, Bolton, Tobey, Rood and Cheney faced off against the pragmatist Hill and was even secretly backed by Rice.¹⁵² The State Department complained that maintaining a policy of ‘squeezing’ the DPRK would turn the talks into nothing more than ‘a surrender mechanism.’¹⁵³ A State Department warned, ‘that if we don’t engage them, first we have the missile tests, and then there will be a nuclear test.’ However, whilst hardliners such as John Bolton called for no concessions on sanctions and Joseph also warned ‘all options are on the table to deal with this threat’¹⁵⁴ and ignoring South Korean and Chinese calls for an end to the BDA and such sanctions, on July 19, his department continued to use Executive Order 13382 to sanction DPRK companies, this time Korea Ryongwang Trading Corporation was targeted.¹⁵⁵

However, it was clear that because of the missile strike and unfavorable events in Iraq, power began to swing from the hardliners to the pragmatists. Rice and Hill’s intention to pursue negotiations now started to override the diminishing power of the

¹⁵¹ Joseph Kahn, North’s Test Seen as Failure for Korea Policy China Followed, *New York Times*, October 9, 2006, at <http://www.nytimes.com/2006/10/09/world/asia/09china.html?pagewanted=print>, (retrieved 10/12/2011).

¹⁵² Chinoy. *Meltdown*, p. 288.

¹⁵³ Sanger, David E., 2009, *The Inheritance: The World Obama Confronts and the Challenges to American Power*, (New York: Harmony Books), p. 334.

¹⁵⁴ Editorial, Bush ‘Has Not Ruled Out’ Any Action on N. Korea, Iran, *Chosun Ilbo*, March 10, 2006.

¹⁵⁵ US Department of the Treasury Office of Foreign Assets Control, Treasury Targets North Korea Entities for Supporting WMD Proliferation: Korea Ryongwang Trading Corporation, July 19 2005, at <http://usinfo.org/wf-archive/2005/051021/epf503.htm>, (retrieved 22/11/2011).

neo-cons. By mid-September 2006, Hill, was even secretly working on bringing an end to the BDA sanction as he quietly asked for bilateral meetings.¹⁵⁶ Zelikow, who drafted policy paper for Secretary of State Rice arguing, ‘The destruction of BDA had achieved its objective’, also backed him. It was an ‘exemplary strike that had already achieved, and was continuing to achieve, the desired informal effect on the DPRK’s access to the international financial system.’ He now urged that an appropriate way be found to release the impounded BDA funds ‘in a way that reinforced and restarted our overall diplomatic strategy.’ Though he shared the ideas with South Korea, nothing came of it.¹⁵⁷ Even the previously hard-talking ambassador Alexander Vershbow indicated, ‘that we are prepared to continue to discuss the same issues discussed in New York. But there are plenty of opportunities to do that in the context of Six-Party Talks, where many different contexts take place.’¹⁵⁸ Although division remained, power began to swing from the hardliners to the pragmatists and the realization that a withdrawal from the BDA was needed was made.

4.7 Stage 6: Oct - Dec 2006 - DPRK Nuclear Test

On October 8, 2006, North Korea conducted its first underground nuclear test. The US ‘condemned the provocative act’ and reaffirmed its ‘full range of our deterrent and security commitments’ to allies in the region.¹⁵⁹ The DPRK blamed the US policy of ‘sanctions and blockade’ as leading to the test. Though UN resolution 1718 quickly passed and sanctioned North Korea even further, especially in the areas of weapons,

¹⁵⁶ Chinoy. *Meltdown*, p. 288.

¹⁵⁷ Ibid. pp. 289-90.

¹⁵⁸ Lee Chi-Dong, US May Link N.K. Financial Problem to Nuclear Talks: Vershbow, *Yonhap*, March 17, 2006

¹⁵⁹ White House, President Bush's Statement on North Korean Nuclear Test, October 9, 2006, at <http://georgewbush-whitehouse.archives.gov/news/releases/2006/10/20061009.html>, (retrieved 16/11/2011).

advanced technology and luxury goods,¹⁶⁰ the DPRK made it clear that it was ready for ‘both dialogue and confrontation’ depending on US response.¹⁶¹

China characterized North Korea’s behavior as ‘brazen,’ and expressed its ‘resolute opposition’ to the test and said it ‘defied the universal opposition of international society,’ but it urged all parties to resolve the issue through ‘consultation and dialogue.’¹⁶² Although Beijing agreed to sanction the DPRK, John Bolton noted that they did not want to cover North Korean illicit activities other than proliferation, such as counterfeiting and narcotics. Having witnessed the harm that the BDA had caused it seemed the Chinese were reluctant to implement similar sanctions.¹⁶³ In fact, Tang Jiaxuan, head of International Department, met with Secretary of State Rice and was even clearer than before in telling her that if Pyongyang could be assured the U.S. was ready to settle the BDA issue, the North would be ready to resume six-party talks. He urged the U.S. to ‘take a more active and flexible attitude.’¹⁶⁴

In South Korea President Roh resisted pressure for sanctions, especially demands to shut down Kaesong Industrial Complex and the Mount Kumgang tours, and told Rice ‘you Americans keep on saying you want this resolved diplomatically, but you are always putting up more hurdles.’ The chemistry in their meeting was so poor that one senior defence official described Rice as having been ‘pissed off.’¹⁶⁵ With cooperation with the Americans seemingly impossible, President Roh initiated

¹⁶⁰ United Nations Security Council, Security Council Condemns Nuclear Test By Democratic People’s Republic of Korea, *Resolution 17185 SC/8853*, (14 October, 2006), at <http://www.un.org/News/Press/docs/2006/sc8778.doc.htm>, (retrieved 17/11/2011).

¹⁶¹ KCNA, DPRK Foreign Ministry Spokesman on US Moves Concerning Its Nuclear Test, October 11, 2006.

¹⁶² Editorial, North Korea Claims Nuclear Test, British Broadcasting Service, October 9, 2006, at <http://news.bbc.co.uk/2/hi/6032525.stm>, (retrieved 17/11/2011).

¹⁶³ Bolton, *Surrender Is Not an Option*, p. 305.

¹⁶⁴ Chinoy. *Meltdown*, pp. 303-4.

¹⁶⁵ *Ibid.* p. 301.

secret contact with the North Koreans.¹⁶⁶ Then, when the President came to meet President Bush at the November APEC Summit in Vietnam, the tensions between the two leaders were ‘palpable.’ Here Roh refused to take part in PSI inspections and to impose sanctions on North Korea while at the same time appealing for the US to sign a peace treaty.¹⁶⁷ It also became apparent that the President was sounding out proposals made by the DPRK to begin secret bilateral talks.¹⁶⁸

However, in the US, the administration was not yet fully committed to the ending of the BDA and felt that in the immediate wake of this nuclear test, their response had to be tough. As Hill put it, the strategy of Secretary Rice and others in the administration still remained as a ‘two track policy. On the one hand we will squeeze. On the other hand we’ll talk.’¹⁶⁹ Rice was preparing for her imminent departure to Asia and stressed her intentions were not simply to ‘restart’ the six-party talks, a move that would have meant ending the BDA. Moreover, President Bush was adamant now that China was ‘coming our way’ and that ‘we should see if the squeeze works’.¹⁷⁰ Hill, much to the annoyance of Rice, sensed that the dominance of the hardliners was in ‘retreat’ and established secret bilateral relations with the DPRK and worked with Zelikow to end the sanctions.

4.8 Stage 7: Jan – June 2007 – BDA Withdrawal

As the aftermath of the nuclear tests settled the stalemate that had existed for more than a year looked to be coming to a close as both the US and DPRK made somewhat

¹⁶⁶ Yonhab News, Roh Admits to Instructing Secret Contact with North Korea, *Hankyoreh*, April 10, 2007, at http://english.hani.co.kr/arti/english_edition/e_national/202213.html, (retrieved 20/11/2011).

¹⁶⁷ David E. Sanger, Bush Praises Vietnam’s Rise, *New York Times*, November 18, 2006, at <http://www.nytimes.com/2006/11/18/world/18diplo.html?pagewanted=print>, (retrieved 18/11/2011).

¹⁶⁸ Editorial, Roh Admits to Instructing Secret Contact with North Korea, *Hankyoreh*, April 10, 2006.

¹⁶⁹ Chinoy, *Meltdown*, p. 306.

¹⁷⁰ Bolton, *Surrender Is Not an Option*, p. 310.

conciliatory gestures to each other. On October 20, a Chinese envoy quoted Kim Jong-Il as having said that he was 'sorry' for the nuclear test and wished to return to talks with the U.S. 'If the U. S. makes a concession, we will also make a concession, whether it be bilateral talks or six-party talks.'¹⁷¹ The DPRK was clearly looking for a reciprocal relationship with the US and talks that by virtue of their beginning would bring an end to the BDA. In the US, a reversion to the policy of 'hawk engagement' seemed to be underway as Victor Cha, argued for face-to-face contact with North Koreans to test whether the North was serious about implementing the September 2005 Joint Statement. He noted that if negotiations fell apart, the U.S. would be in a better position to enlist others for tougher sanctions. This was a return to a policy of engagement rather than coercion.¹⁷² At NSC meeting Rice argued for opening real negotiations with the North. She posed the question of whether sanctions could 'force' North Korea to change its behaviour or if 'we going to give them a chance and try to reopen the diplomatic track?' The hardliners pushed back and one participant recalled: 'Cheney looked like he was going to be ill.' It was evident now that even hardliner figures were favoring engagement that would lead to the end of the BDA.¹⁷³

On December 12, 2006 and on December 15, a real change in approach by the Bush administration was evident as Secretary Rice hinted at flexibility on BDA in an interview with Reuters, 'We're not going to allow them to continue to violate our laws, but obviously we'll look at the totality of all of this and see where we are after the next couple of rounds.'¹⁷⁴ An Ernst & Young audit of the BDA also released its

¹⁷¹ Associated Press, "China Says Rice, China's Li Call for North Korea Talks, Appeal for Restraint," *USA Today*, October 20, 2006, at http://www.usatoday.com/news/world/2006-10-19-rice-south-korea_x.htm, (retrieved 02/02/2012).

¹⁷² Chinoy, *Meltdown*, p. 310.

¹⁷³ Sanger, *The Inheritance*, p. 329.

¹⁷⁴ Jack Jim, Rice Hints at Flexibility on North Korea, *Reuters*, December 16, 2006, at <http://uk.reuters.com/article/2006/12/16/us-korea-north-talks-idUKPEK6675320061216>, (retrieved 21/11/2011).

findings and notes that 'From our investigations it is apparent that... (BDA) did not introduce counterfeit US currency notes into circulation.' U.S. Treasury officials said their own investigation, which reviewed about 300,000 documents, had 'confirmed our suspicions' about the bank's activities. But the results of separate investigations in Macao did not support the US charges against the bank and were refuted.¹⁷⁵ This offered the Treasury Department and the US government a potential exit route from a BDA that experts such as Markus Noland claimed 'were bringing cascading effects to North Korea' so that its 'economy was affected more by the Macao financial sanctions than the official sanctions put forth by the UN.'¹⁷⁶

At this point China begins to urge haste for the US to unfreeze DPRK bank accounts. Foreign Ministry spokesman Liu Jianchao called for more progress over US sanctions on North Korea's accounts in BDA that he described as 'a matter hampering progress in six-party talks on the North'. He explained that the Chinese position was that 'We hope the US and North Korea can reach consensus on the issue so it can be solved at an early date and we can eliminate the unnecessary obstacles standing in the way of the process of the six-party talks.'¹⁷⁷ South Korea was also looking to not only to end the sanction but also begin concrete steps to restart talks with the DPRK. A step ahead of China, it asked the US to consider selectively unfreezing at least five of North Korea's 50 accounts, saying part of the US\$25 million North Korean accounts were acquired legitimately. Boldly pushing the US to end the BDA and taking

¹⁷⁵ Donald Greenlees, Macao inquiry clears bank of money laundering for N. Korea, *New York Times*, March 12, 2007, at <http://www.nytimes.com/2007/03/12/world/asia/12iht-bank.4881172.html>, (retrieved 02/02/2012).

¹⁷⁶ Editorial, U.S. Sanctions Hurting North: Expert, *Dong-A Ilbo*, January 4, 2007.

¹⁷⁷ Editorial, China Urges Haste Over North Korea's Frozen Bank Accounts, *Chosun Ilbo*, January 10, 2007, at http://english.chosun.com/site/data/html_dir/2007/01/10/2007011061024.html, (retrieved 23.12.2011).

concrete steps that would help reproach their relationship with the DPRK, it was evident that both China and South Korea wanted progress on its resolution.¹⁷⁸

Following such calls for progress and a softer US position, Six-Party Talks were restarted, as bilateral negotiations on the issue permitted their resumption. The DPRK was adamant that nothing would be talked about until the BDA issue was resolved. As Hill noted, ‘They had a hard time talking about anything but the BDA.’ ‘They have had strict instructions from their capital that they cannot engage officially on the subject of the Six-Party Talks until they have the BDA issue resolved.’¹⁷⁹ KPA Chief of the General Staff Kim Yong chun even threatened that if ‘enemy forces continue to increase their sanctions and pressure, we will respond with stronger and more resolute countersanctions.’¹⁸⁰ Dynamics within Washington however, by now had changed and though hardliner figures such as Aaron Friedberg still felt that ‘instead of backing off, the president should authorize the imposition of further financial sanctions on the North.’¹⁸¹ At this juncture, pragmatists began to really drive policy. Zelikow said the policy switch was set in motion in the autumn of the previous year after the DPRK had conducted a nuclear test. He cited three primary reasons. Firstly the Bush administration was at an approval rate of 30% and ‘they needed a success in the face of Iraq, Iraq, Iraq all the time.’ Secondly political difficulties of the administration had strengthened ‘Rice’s willingness to join with the president in offering some strong leadership in this area’ and push for the Six Party-Talks that he wanted. Thirdly, the departure of Secretary of Defense Donald Rumsfeld and the

¹⁷⁸ Editorial, Seoul Asked U.S. to Unfreeze North Korean Accounts, *Chosun Ilbo*, January 23, 2007, at http://english.chosun.com/site/data/html_dir/2007/01/23/2007012361019.html, (retrieved 23.12.2011).

¹⁷⁹ Lee Jo-hee, Process of Beijing Talks under Scrutiny, *Korea Herald*, December 23, 2006.

¹⁸⁰ Editorial, North’s Kim Yong-Chun: We Will Respond with Strong Countermeasures if Sanctions and Pressure Intensify, *Segye Ilbo*, December 23, 2006.

¹⁸¹ Dan Blumenthal and Aaron Friedberg, Not Too Late to Curb Dear Leader, *Weekly Standard*, 12, No. 21, February 12, 2007, at <http://www.weeklystandard.com/Content/Public/Articles/000/000/013/246vdcgk.asp>, (retrieved 04/03/2012).

Pentagon's subsequent withdrawal from frontline foreign policy had made diplomacy easier. It was now the State Department, led by Hill that was driving policy. As a close observer noted, 'there was no resistance in the White House to what Chris [Hill] was doing.'¹⁸²

With the power to push US-DPRK policy, Hill began bilateral talks with the North in Berlin. Limiting the exposure of the talks to key members of the administration, only Rice, Hadley Victor Cha and a small number of trusted aides were kept 'in the loop,' as they the talks were 'kept very quiet.' At the talks, North Korea agreed to halt the Yongbyon reactor and allow IAEA on-site monitoring in return for economic and energy aid and unfreezing of \$25 million in BDA.¹⁸³ Hill, not able to act with conviction, agreed to this and after a series of further talks a breakthrough agreement was reached on February 13, 2007. In announcing this agreement, Assistant Secretary of State Christopher Hill pledged to settle with North Korea within 30 days the issue of US financial sanctions against BDA and the freezing of North Korean accounts of \$25 million. All of the funds belonging to the North Koreans that had been frozen before were being unfrozen to reciprocate the positive steps the North Koreans had taken towards freezing their Yongbyon nuclear reactor and readmitting IAEA inspectors, with a future goal towards total nuclear disarmament of the Korean peninsula.¹⁸⁴ After several delays and failed attempts to transfer the \$25 million, the DPRK recovered its funds in June 2007 when the New York Federal Reserve Bank agreed to transfer them through its facilities to a bank in

¹⁸² Karen De Young and Glenn Kessler, Policy Success -- or U-Turns, *Washington Post*, March 11 2007, p. A-18.

¹⁸³ Editorial, N. Korea Ready to Suspend Nuclear Activities, *Chosun Ilbo*, January 21, 2007.

¹⁸⁴ David Lague and Donald Greenlees, Thursday, January 18, 2007 Squeeze on Banco Delta Asia hit North Korea where it hurt - *Asia - Pacific - International Herald Tribune*, at <http://www.nytimes.com/2007/01/18/world/asia/18iht-north.4255039.html>, (retrieved on 18/06/2011).

Russia.¹⁸⁵ Finally the BDA sanction was ended and agreement to re-engage on the denuclearization issue between North Korea and the US established.

In the aftermath of the BDA's withdrawal hardliners and pragmatists still remained divided on the sanction. On April 18, 2007, in front of a Joint Hearing before the Subcommittee on Terrorism, Nonproliferation and Trade of the Committee on Foreign Relations, David Asher claimed that 'Banco Delta was a symbolic target,' chosen to 'kill the chicken to scare the monkeys, and the monkeys were big Chinese banks doing business with North Korea,' To this regard, 'The action against Banco Delta Asia had a ripple effect; never a popular business partner, North Korea found itself cut off from most of the banks that had previously done business with Pyongyang.' Financial matters aside, he claimed that the 'DPRK was brought back to the six-sided table at least in part due to the pressure exerted by the Treasury's actions against Banco Delta Asia.' He criticized Hill and stated that he should 'not trade progress on denuclearization by turning a blind eye to some of these illicit activities' and noted that with regards to the imposition of sanctions, 'You have to be tough.'¹⁸⁶

In contrast pragmatists like Chris Hill felt that America had in fact been 'the victim' of efforts to 'tighten the noose' on North Korea, and blamed 'Washington politics' for blocking progress of the issue of denuclearization. Unlike hardliners such as Asher who wanted to maintain the BDA, Hill had effectively worked to not 'allow \$26 million or \$25 million to get between us and a deal that will finally do something about nuclear weapons on the Korean peninsula.' Even until its withdrawal, the BDA remained a divisive tool revealing the political factional problems of the US

¹⁸⁵ Perl, R., & Nanto, D.K. (2007), *North Korean Counterfeiting of US Currency*, p 23.

¹⁸⁶ David L. Asher, Ph.D.: Prepared Statement, *Joint Hearing before the Subcommittee on Terrorism, Nonproliferation and Trade of the Committee on Foreign Relations*, April 18, 2007, at <http://foreignaffairs.house.gov/110/34715.pdf>, (retrieved 04/04/2012).

government.

2006 was a year of confrontation, culminating in North Korea's missile and nuclear tests and the tightening of both multilateral and bilateral sanctions, 2007 was characterized by a gradual rapprochement as the issue was overcome.¹⁸⁷ Although it was clear that while the BDA designation had the intended effect of cutting off North Korea's access to the international financial system, the strategy was ultimately proving counterproductive. As it became increasingly apparent that finding a way out of the deadlock was central to broader progress on the nuclear issue, it became a huge stumbling block until its eventual withdrawal.¹⁸⁸ Though the sanction had 'killed the chicken' and 'scared the monkey', as part of 'hawk coercion' it had also tightened the noose so severely that it strangled progress on denuclearization.

¹⁸⁷ Stephan Haggard and Marcus Noland, *North Korea in 2007: Shuffling in from the Cold*, Asian Survey, Vol. 48, No. 1, (January/February, 2008), pp. 1-2.

¹⁸⁸ Chinoy. *Meltdown*, p. 315.

Chapter V

Framework Analysis: BDA Failure in Coercive Terms

This section of the paper will look at the data collected in the Descriptive Analysis in order to determine the validity of the three hypotheses that this paper proposed in chapter IV. It was proposed that (1) the lack of South Korea's support (2) the lack of China's support and (3) the change of objectives by the US government led to the withdrawal of the BDA sanction. By measuring the changes in allied support and US objectives that occurred during the entirety of the BDA affair, the validity of each hypothesis will be tested and the most fundamental reason found. Furthermore, Bruce Jentleson's framework of coercive diplomacy will be applied as a means to better understand and more deeply explain the roles and changes these variables made throughout the period of BDA sanction's implementation.

5.1 ROK & PRC Support for US-DPRK Policy

The level of support that China and South Korea gave to the US with regards to its DPRK policy must first be analysed. In order to do so, this analysis, which was divided into seven time periods, each exploring the actions, reactions and policy changes of South Korea, China, North Korea and the United States, will be investigated. Each time period reflects an important stage in the BDA sanctions implementation and read as:

- 1) Sept 2005 - BDA Implementation
- 2) 9.19 Agreement
- 3) Oct - Dec 2005 - North Korean Linkage
- 4) Jan - June 2006 - Hardened US Position

- 5) July - Sept 2006 - DPRK Missile Tests
- 6) Oct - Dec 2006 - DPRK Nuclear Test
- 7) Jan - June 2007 BDA Withdrawal

By looking at the statements released by the respective leaders and governments of South Korea and China over these seven stages we can see that in the 'pre-BDA' period the US, South Korea and China are following policies independent of each other. The Roh government was pursuing engagement, the Hu government stability and the Bush government isolation. Thus, there was no support from China and South Korea as their policies did not align with those of the United States and government, and the statements reflect this. From stage one however, we see a convergence in policy as all three parties, in the process of agreeing with the DPRK, Russia and Japan to sign the 9.19 Agreement agree that the goal of tackling financial crime is a legitimate one. In stage two, upon the actual signing of the 9.19 Agreement, all three states release statements of satisfaction with the progress made by the signing and a period of policy harmony is evidence. At this point the BDA sanction, implemented four days prior, has gone largely unnoticed by South Korea and China and does not cause any significant drop in support for US policy, though Seoul does register concern.

It is in stage three, 'After Clear North Korean Linkage' that we see support from both allies begin to fall as negative statements from South Korea appear. It calls evidence related to the charges made against the bank as 'inconclusive' whereas China seemingly ignore DPRK linkage and conduct a business-as-usual approach to their priorities of engagement and stability by signing an economic agreement with the North. As the US position on the BDA hardens on the BDA in stage four as it

stands by its intention to crack down on illicit crime and claims that it is independence of talks on denuclearisation it is apparent that the ROK and PRC are not so adamant of the sanction's necessity. In particular South Korea notes that it has disagreements with the US and insists that such illicit acts conducted by the North are old news. China however, in purporting to be actively conducting investigations into the BDA can be said to be offering greater support than its neighbours. It does though also stress that a solution must be found to overcome the issue.

It is in stages five and six that the real change in support occurs. It suffers a blow after the DPRK's missile launch causes an increase in negative statements with regards to the BDA and thus a fall in the support is evident. South Korea's open rejection of the policy and its harsh language mean that it is more openly withdrawing support for the sanction and thus registers lower support than that of China. By stage six, when the DPRK conducts its first nuclear test, support is withdrawn, calls for an end and resolution to the BDA crisis demanded and statements that contradict and bypass the sanction are evident. Support from China and South Korea for US DPRK policy is not regained until the US effectively drops the BDA and realigns its policy to match the goals of its allies. At this point, embodied in the signature of the 9.19 Agreement, we see policy convergence and the support is high.

In conclusion it is clear that as a general trend both South Korean and Chinese support decreased the longer the BDA sanction was in place. Initial support for the sanction was stronger in China and took longer to reach a point where there is no support and the state demands an end to the policy. Nevertheless, once North Korea acts in a threatening manner, it withdraws support and labels the sanction 'regretful'. In South Korea the trend is also similar but the rapidity of support-withdrawal is

higher. Upon North Korean linkage of the BDA to denuclearisation, statements reveal that the Roh administration began to retract support. Less vocally supportive than China, it decides to call for an end to the BDA earlier, at stage four when the US is hardening its position and China is maintaining a supportive stance. The complete loss of South Korean support, like that of China's, occurs after the DPRK's nuclear test, when both states call for an end to the BDA and work to negate and bypass it.

5. 2 South Korea/US Relations & Coercive Credibility

The support that South Korea gave to the BDA sanction, and the decrease in the level of support over the period of its implementation has been shown. Now, in order to ascertain the reasons this occurred, how it more broadly influenced the coercive diplomatic policy of the Bush administration at this time and how it may have contributed to the failure of the BDA as a coercive tool, Bruce Jentleson's framework will be applied.

According to Jentleson the three elements of a balanced coercive diplomacy strategy, proportionality, reciprocity and coercive credibility, are more likely to be achieved if other major international actors are supportive. For such support to be fostered he notes that a common interest between allies, a perceived reasonable objective and credible superior strength of the US needs to be attained. It is these parameters that will be applied to the BDA sanction in order to analyse the drop in South Korean support for the sanction.

5.2.1 Superior Strength

Jentleson explains that an ally must be confident that the coercer state has the adequate strength to effectively ‘intimidate’ the target state.¹⁸⁹ This ability to threaten the target state is not entirely attributable to military power, though this is an important element, as superior strength also requires political and economic influence. Therefore, in order to ascertain whether the US held sufficient superior strength these three key areas must be investigated.

Firstly, it is clear that during the period that this paper has isolated for research, the US exhibited substantial political and economic power. Politically, it passed two comprehensive resolutions against North Korea (1874, 1718) and managed to broker consensus between regional allies for a substantial period. On an economic level, it stopped aid shipments to Pyongyang and implemented a number of sanctions such as the October 2005 blacklisting of DPRK firms and December 13 financial warnings as well as the BDA. The BDA itself was considered to have had a substantial ‘avalanche’ effect and to have been an ‘exemplary strike that achieved the desired informal effect on the DPRK’s access to the international financial system.’¹⁹⁰ The fact that as a consequence of the sanction by April 2006 over twenty institutions in Australia, Vietnam, Mongolia, and China has taken the decision to deny financial services to North Korea shows the economic and political influence of the US. The soft power of the US and its ability to affect North Korea’s financial standing was evidenced.

Secondly, on the military front, wars in both Afghanistan and Iraq were testament to US military capabilities to act preemptively. As well as this, statements

¹⁸⁹ Jentleson and Whytock, *Who “Won” Libya?*, pp. 52-53.

¹⁹⁰ Chinoy, *Meltdown*, pp. 289-90.

that were made throughout the BDA affair regarding military options that included a strike to destroy the North Korean Taepodong missile after their launch in June 2005, reflected American readiness to consider military options.¹⁹¹ George Bush even reiterated his willingness to use the ‘full range of our deterrent and security commitments’ to allies in the region.¹⁹² Thus, it is unlikely that South Korea ever doubted the economic, political and military strength of the United States to credibly exact threats it made towards the DPRK.

5.2.2 Common Interest

According to Jentleson’s framework, a common interest between the coercer and its allies is a crucial element necessary to achieve coercive credibility and thus the interests of both South Korea and America must be analysed in order to determine the extent to which it achieved commonality.

Principally both states had compatible policy goals as they sought to denuclearise North Korea, but the US policy was far more complex to that of South Korea as it pursued three tracks: a coercive strategy to end alleged nuclear weapons program, PSI and its involvement in international crime, to their one: economic and political engagement. Thus, the common interest between these two was not a simple one and the relationship between their interests often clashed. The table below depicts the eight stages into which the BDA affair can be broken into based upon the events that took place and how the interests of each country differed.

¹⁹¹ Ashton B. Carter and William J. Perry, If Necessary, Strike and Destroy, *Washington Post*, June 22, 2006.

¹⁹² White House, President Bush’s Statement on North Korean Nuclear Test, October 9, 2006, at <http://georgewbush-whitehouse.archives.gov/news/releases/2006/10/20061009.html>, (retrieved on 16/11/2011).

Table 5.1
US-ROK Interest Commonality

Stage	Date	Event	Dominant Policy-making Group	US Behavior	ROK Behavior	Common Interest	Role of South Korea
Pre	Pre 9.2005	Pre BDA	Hardliner	CVID, No talks, negative rhetoric	Peace & Prosperity Policy	NO	Independent
1	15. 9.2005	BDA Implemented	Hardliner	BDA implementation	Enforce BDA +9.19 progress	YES	Quietly Supportive
2	19.9.2005	9.19 Agreement	Pragmatist	9.19 Agreement Signed	9.19 Agreement Signed	YES	Cooperative
3	11-12.2005	DPRK Linkage	Hardliner	Further BDA measures	Support BDA + 9.19 priority	Partial	Divided
4	01-06.2006	Hardened US Position	Hardliner	Stronger support for BDA	Doubt about BDA, signs of non-cooperation	Partial	Suspicious
5	07-09.2006	Missile Launch	Pragmatist	BDA support weakens, but enforced	Request to end to BDA	No	Uncooperative
6	10-11.2006	Nuclear Test	Pragmatist	Attempts to overcome BDA, but enforced	Refusal to join PSI & Sanction	No	Disruptive
7	12.2006-02.2007	Withdrawal	Pragmatist	BDA Withdrawal & February Agreement	February Agreement	Yes	Cooperative

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It is clear that common interest was only apparent in the absence of or initial implementation of the BDA sanction. During President Bush's first term in office, South Korea had taken an 'independent' position on North Korea as its Peace and Prosperity policy of engagement clashed with US isolationist policies and its demands for CVID. While hardliners led the policy, specifically under the guidance of Vice President Cheney and Undersecretary of State for Arms Control and International Security, John Bolton, no common interest was found with the progressive Roh administration. However, during stage one, just prior to the BDA's implementation, with policy driven by pragmatists in the State Department, commonality was found as the 9.19 Agreement signed and North Korea promised to end its nuclear program –

¹⁹³ Table compiled by S. Blakeley with use of research conducted in the Descriptive Analysis chapter of this paper. The 'dominant political group' was determined by using the political commentary of Mike Chinoy's *Meltdown* that documents the shifts in power through this period. The time periods was matched to his interpretation of these shifts to isolate which group had most power at a particular time. Reading various government statements that indicated directly or indirectly notions of interest established the existence of a 'common interest'. These can be found throughout the 'descriptive analysis' section of this paper. The 'role of South Korea' field was determined by reading political commentary on the events of the affair and newspaper articles at the time. Quotes from the political commentary appear throughout the 'descriptive analysis' section of this paper.

the overall goal of both partners.

However, we see a gradual erosion of their common interest after the implementation of the BDA sanction. Initial reluctance upon implementation, then division after linkage, non-cooperation on the sanction, requests for its withdrawal and refusal to act in accordance with it. Stage two to four are most significant as the initial reluctant support for the BDA sanction, based upon the assumption that it would not interfere with Seoul's engagement policy, alters to division and then rejection as North Korea links the sanction to the denuclearisation issue and America refuses to back down.

Initial South Korean support for the BDA sanction, was forthcoming when the objective of the BDA was seemingly one related to financial matters and not related to denuclearization. However, when it was realized after DPRK linkage that the sanction would impact directly on denuclearization it began to worsen relations between South Korea and the US as it seemed to have 'buried' the 9.19 Joint Agreement and jeopardized the main common interest which united South Korea and the US. At this point we see South Korea adopt a far less supportive role. South Korea can be said to have assumed the following positions as the BDA affair progressed: quietly supportive -> divided -> suspicious -> uncooperative -> disruptive. As the Six-Party Talks process as a whole was entering a critical phase of substantive resolution of the North Korean nuclear issue, a practical approach was needed. However, the BDA sanction was much more hardliner than pragmatic.

Ultimately, the Seoul government could not find commonality with a hardliner-drive BDA sanction and adopted a position that undermined the sanction. For

example, it stressed that any illicit North Korean financial activities could not be tolerated but that punishment should be based on clear evidence and for such sanctions to be viewed with consideration for the ‘related efforts to resolve the nuclear issue.’ President Roh attacked the right-wing elements of the US administration that wanted to apply greater pressures on the North Korean government in order to instigate its collapse and stated that ‘if the US government tries to resolve the problem that way, there will be friction and disagreement between South Korea and the US’ The ROK government seemed to want the US to ‘let bygones be bygones’ in exchange for engagement on the nuclear issue – a more pragmatic policy.¹⁹⁴ As their common interest diverged, the Roh government was uncooperative on an enquiry, refused to implement sanctions on North Korea, raised suspicions about BDA-related evidence, publicly challenged US policy and even secretly met North Korean officials to overcome the issue.

When pragmatists in the State Department were driving Washington policy, Seoul felt it shared a common interest with the US in engaging the DPRK, so they were cooperative and signed both the 9.19 and February Agreement. However, as hardliners ‘hijacked’ the BDA and used it as a tool to coerce North Korea, then support weakened to the point of disruption, as common interest was lost. South Korea made repeated attempts to resolve the BDA issue, ask for its withdrawal and even work against it, but all indicators were rebuffed by hardliners in the US until after the DPRK’s nuclear test.

It is clear that the BDA issue actually divided the common interest that had existed between South Korea and the US and led to the 9.19 Agreement. The longer

¹⁹⁴ Emma Chanlett-Avery, et. al, *North Korea: A Chronology of Events in 2005*, p. 24.

the issue lasted, the more that the Bush administration continued to pursue the BDA sanction, the more divided their interests became and the less supportive Seoul was. Its role transformed from one of 'quiet support' to 'disruptive' over a period of twenty-one months. Without any common interest to bind the allies, South Korean support for the sanction fell.

5.2.3 Reasonable Objective

According to Jentleson's framework the sanction pursued by the coercer must be perceived as having a reasonable objective by its allies in order to garner their support and thus attain coercive credibility. In the case of South Korea and the US it seems that the perception of the objective's reasonableness deteriorated over time and led to the loss of South Korean support and subsequently coercive credibility.

A study of the language used from stages two to seven reflects the changes in perception that occurred over the BDA period. Initially it was viewed as 'related to law enforcement,' and that 'it should not be an obstacle which would hinder the Six-Party Talks process.' At this point, the objective of the BDA is considered reasonable. In stage two the reasonableness of the sanction is maintained as it does not become an obstacle to the signing of the 9.19 agreement. However, after North Korea links the BDA sanction to the denuclearization issue and views it as an unreasonable act that was 'scuttling talks' and was a 'wanton violation and distortion of the joint statement,' then South Korea began to see its objective as unreasonable. This was not because the DPRK saw it as unreasonable, but because such linkage effectively derailed their critical goal of denuclearization. The subsequent attempts by South Korea to undermine the sanction by not implementing sanctions as requested by the US and

pursuing bilateral relations with North Korea in parallel with its imposition. As well as requests to see the evidence connected to the charges it related too as well as requests by President Roh to President Bush for the sanction to end, reflect actions that would imply that their perception of the sanction was that it was indeed unreasonable.

As the US position hardened the perceived unreasonableness of the sanction rises as it is labeled 'inconclusive', a 'hurdle' and an 'obstacle', the perception of the BDA as inappropriate, sabotaging and/or incompetent means that the sanction was not seen as being a 'reasonable objective.' Without this necessary perception, support for the sanction from South Korea was not forthcoming.

Statements made by decision-makers in Washington that the BDA sanction was an IAI tool for 'pressuring Kim Jong Il to back away from his nuclear weapons development and missiles programs' by attempting to 'create serious and credible leverage,' and claims that it was 'comprehensive' in scope and that could 'reinforce prospects for talks' signaled to Seoul that the policy-goal of the BDA was beyond financial. Furthermore, figures such as Bob Joseph stating that, 'we need to see transformation' and harsh US rhetoric calling the DPRK leaders 'tyrants,' 'criminal' and 'Hitler-like,' in the context of the neo-con dominated Bush administration, would have indicated to Seoul that the objective, rather than being limited to criminality was far more aggressive and broad. Whilst South Korea exhibited support for a 'law enforcement' objective, once the hardliner-driven BDA sanction came to be perceived as being motivated by a grander, coercive goal, the support waived.

5.3 China/US Relations & Coercive Credibility

As was previously shown, Chinese support for the BDA sanction deteriorated over time and was ultimately withdrawn when DPRK acts of aggression jeopardized their policy of regional stability. In order to understand the reasons for this, Jentleon's framework will be applied once again to see if a common interest between allies, a perceived reasonable objective and credible superior strength of the US were evident in this case.

5.3.1 Superior Strength

As it was with South Korea, the economic, political and military capabilities of the US were such that their credible threat in these areas was not in doubt. Though China holds greater military and economic strength than South Korea it too reflected confidence in US strength. Economically, China reacted to its financial sanction by conducting investigations into its own banking systems. Politically it backed a more hardliner approach to the DPRK after its nuclear test than it had before. Militarily, as was the case with South Korea, US assertions of a willingness to use military power to defend allies as well as troops stationed in Korea and Japan point to sufficient force for China to believe that it could support threats with force.

5.3.2 Common Interest

With superior strength sufficiently present, an understanding of how the commonality of interest and reasonableness of objective influenced Chinese support must be analyzed. By breaking down the trend of support into the seven stages of the BDA affair, it is possible to see the manner in which Chinese support changed.

Table 5.2
US-PRC Interest Commonality

Stage	Date	Event	Dominant Policy-making Group	US Behavior	PRC Behavior	Common Interest	Role of PRC
Pre	Pre 9.2005	Pre BDA	Hardliner	CVID, No talks, negative rhetoric	Economic support, engagement	NO	Indipendent
1	15. 9.2005	BDA Implemented	Hardliner	BDA implementation	Enforce BDA +9.19 progress	YES	Cooperative
2	19.9.2005	9.19 Agreement	Pragmatist	9.19 Agreement Signed	9.19 Agreement Signed	YES	Actively Supportive
3	11-12.2005	DPRK Linkage	Hardliner	Further BDA measures	Supports BDA investigation + 9.19 priority	YES	Actively Supportive
4	01-06.2006	Hardened US Position	Hardliner	Stronger support for BDA	Support for BDA, Informal Six-Party Talks, negative on BDA	Partial	Support in investigation, partly negative
5	07-09.2006	Missile Launch	Pragmatist	BDA support weakens, but enforced	Veto unused, worsening of DPRK-PRC relations, calls for resolution	Partial	Negative
6	10-11.2006	Nuclear Test	Pragmatist	Attempts to overcome BDA, but enforced	Complaint on US refusal to resolve BDA, informal attempts to help resolve	No	Disruptive
7	12.2006-02.2007	Withdrawal	Pragmatist	BDA Withdrawal & February Agreement	February Agreement	Yes	Cooperative

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Prior to the BDA, Beijing, like Seoul, sought to engage the DPRK and welcomed the progress that led to the signing of the 9.19 Agreement. Upon implementation of the BDA sanction, Chinese common interest with the US remains, despite the fact that the bank itself is based in Macau, a Special Administrative Region of the People's Republic of China. It actually consistently calls for its institutions to be careful of North Korean abuse and investigates suspected wrongdoing and in stages two and three we witness Chinese active participation in the BDA investigation, though they continue to place high-priority on the progression of the 9.19 Agreement and remain on friendly terms with North Korea – indicated by the signing of new economic agreements. They clearly viewed the BDA sanction as an isolated financial punishment at this point and did not see their interest in maintaining

¹⁹⁵ Table compiled by S. Blakeley with use of research conducted in the Descriptive Analysis chapter of this paper. The ‘dominant political group’ was determined by using the political commentary of Mike Chinoy’s Meltdown that documents the shifts in power through this period. The time periods was matched to his interpretation of these shifts to isolate which group had most power at a particular time. Reading various government statements that indicated directly or indirectly notions of interest established the existence of a ‘common interest’. These can be found throughout the ‘descriptive analysis’ section of this paper. The ‘role of China’ field was determined by reading political commentary on the events of the affair and newspaper articles at the time. Quotes from the political commentary appear throughout the ‘descriptive analysis’ section of this paper.

regional stability as being threatened. However, as they believed the Six-Party Talks to be the most effective way to maintain peace in the region, they did attempt informal talks with the members regardless of the BDA standoff.

The PRC maintains support for the BDA longer than the ROK, though; the direct impact of the BDA on freezing North-South relations, while not detrimentally affecting PRC-DPRK relations up to this point, may explain this. By the middle of 2006 however, we do see some Chinese government discontent as the BDA continues to block denuclearization progress, thus partial commonality is lost. Stage three is indicative of this as China, while concluding a three-month investigation of the accused Macau bank, simultaneously meets with South Korea and pushes the North to overcome the issue. Whilst South Korea more quickly lost their commonality of interest with the US after North Korean linkage, it is not until after the missile launch and nuclear test, in stages five and six, that the same trend occurs. Initially 'actively supportive' and only minimally 'negative', the Chinese now become fully 'negative' with regards to the BDA as they call for a resolution to the affair and also chastise North Korea for its actions. The subsequent nuclear test in stage seven severs commonality completely as China becomes 'disruptive' to the BDA's implementation as it attacks US unwillingness to meet the DPRK bilaterally and allow Christopher Hill to visit Pyongyang. China also shows its unwillingness to adopt UN-led sanctions akin to those imposed on BDA. The Chinese erosion followed the sequence: independent-> cooperative-> actively supportive-> actively supportive-> partially negative-> negative-> cooperative, as the sanction was increasingly seen as counter to Chinese policy goals and lacking commonality. Not until the BDA is withdrawn and North Korea encouraged to sign the February Agreement does stability and thus common interest re-emerge.

5.3.3 Reasonable Objective

In relation to whether the BDA was considered to have had a ‘reasonable’ objective, we can also see a change in perception. This change however is not as stark as that of the ROK. South Korea prioritized denuclearization through engagement and so was never more than ‘quietly supportive’ of a BDA sanction that tackled illicit crimes it was essentially willing to ignore. However, the PRC’s policy of maintaining stability was better served by the introduction of the BDA. Such international crimes could not be ignored and their eradication was seemingly viewed as reasonable. Unlike South Korean President Roh, who expressed early ambivalence to the BDA sanction, China simply tried to work around it, calling for its resolution, informal Six-Party Talks and bilateral US-DPRK communication. The PRC’s warning to its own banks and investigations of alleged fraudulent activities in its banking system reflect the reasonable objective that it believed the BDA to have – ending illicit financing.

The PRC, despite advocating DPRK-US dialogue throughout the period of the affair, did not stipulate belief that the BDA was unreasonable until the actions of North Korea made the objective unreasonable to them. Launching missiles and conducting a nuclear strike undoubtedly destabilized the region and thus jeopardized China’s main policy priority. At this point the BDA is no longer perceived as having a reasonable objective and its withdrawal is called for. It quickly calls for the US to be more flexible, thus implying that the BDA policy had been perceived as inflexible. Eventually China would note that the sanction was indeed ‘regrettable’.

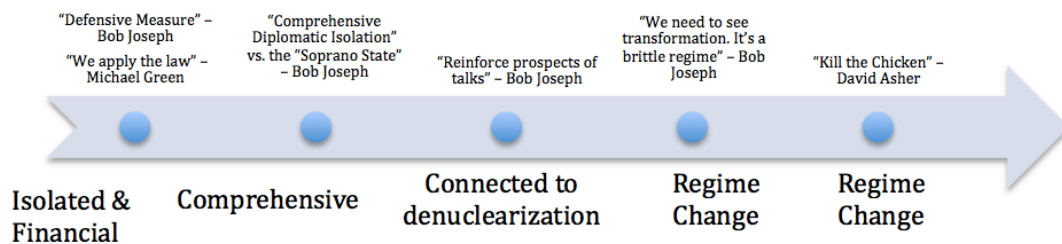
It is evident that the BDA sanction was initially viewed as reasonable and part of a common interest that was shared by the US and the PRC. It seems that whether policies were pragmatist or hardliner-led, mattered little to Beijing as it backed the

sanction and was active in its investigations. However, despite attempts to work-around the sanction, it maintained support until North Korean aggression effectively made the continuance of the sanction unreasonable and China altered from a position where it actively supported it to one where it sought to usurp it and disrupt it. At this point a commonality of interest and the BDA's perception of having a reasonable objective was lost. The process and reason why the goals and perceptions changed will be investigated below by analyzing the internal changes within the US administration at this time.

5.4 BDA Policy Goals

The BDA affair began in September 2005 and ended in June 2007. During this period of twenty-one months the objective of the Bush administration's DPRK policy change. As indicated earlier, the initial policy of hawk engagement was effectively altered to assume a more coercive posture as hardliners took control of the policy. By looking at the statements of the primary hardliner policymakers who were connected to the BDA sanction; Michael Green, Bob Joseph and David Asher, from the beginning of the affair to the end, a clear change is revealed.

Figure 5.3
BDA Policy Goal Changes



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In stage one, when the BDA is initially implemented, it is described as a sanction that is ‘isolated’ from denuclearization and described as an independent financial law-enforcement policy. As the US position hardens in stages three and four and the effect of the policy realized then the rhetoric escalates however. At this point Bob Joseph, one of the architects of the BDA describes the sanction as being part of necessary ‘comprehensive diplomatic isolation’ and later claims that it will actually reinforce the prospect of successful denuclearization talks. Whether helpful or not, the important point is that the BDA is not an isolated sanction and is in fact comprehensive in scope. Later statements that talk of the need for a ‘transformation’ of the DPRK and descriptions of the state as ‘brittle’ reflect the policy objective of destabilizing the North with a view to ‘kill the chicken’ – regime change. In papers that recounted the events of the BDA, David Asher accepts that it was a tool designed to ‘pressure Kim Jong il to back away from his nuclear weapons development and missile programs’ and create ‘leverage’ for the US. These are typical features of a coercive policy and not that of an isolated financial punishment.

¹⁹⁶ Figure 5.4 was made by Sean M. Blakeley. The information shown is based upon the quotes of Michael Green, Bob Joseph and David Asher and the policy goal changes as indicated in the researched made in the Descriptive Analysis of this paper. These figures headed the policy of which the BDA was central and is outlined in The fields were populated from the policy outline in David L. Asher, Victor D. Comras and Patrick M. Cronin’s *Pressure: Coercive Economic Statecraft and U.S. National Security*, *Center for a New American Security*, (January 2011), p. 6.

It is thus evident that the objective of the BDA did alter from that of a limited and isolated financial punishment to one that assumed a far broader policy-goal of destabilizing the DPRK with a view to pressuring the regime and creating leverage in an attempt to coerce them to give up their nuclear ambitions. The IAI reputational sanction effectively turned hawk engagement into hawk coercion and with it altered the policy-goals of the BDA. Initial limited financial goals were changed and broadened as the sanction was maintained.

5.4 US/DPRK Relations: Proportionality & Reciprocity

With the change in policy-goal made clear, the next step is to understand why such a change led to the failure of the BDA in terms of its application as a coercive tool. In order to determine these reasons Jentleson's framework and in particular his focus upon the need for proportionality and reciprocity when attempting to coerce a state, will be implemented.

5.5.1 Proportionality

According to Jentleson's, proportionality refers to the relationship between the scope and nature of the objectives being pursued and the instruments being used in their pursuit. The more the coercer demands of the target, the higher the target's costs of compliance become, thus the greater the need for the coercer's strategy to increase the costs of non-compliance and the benefits of compliance. This section will therefore determine how proportional the objective was and to what extent it was limited in scope. This is because if the objective went beyond that of an isolated financial policy to effectively striving to leverage the DPRK and pressure them to denuclearize, then

the policy would be disproportional and fail.

In the case of the BDA sanction, as was shown above, it is evident that its objective actually changed throughout the twenty-one months it was in place. As actors drive objectives, it is now important to understand the position that these decision-makers had on North Korea. The administration had two significant factions that influenced policy-making in the US; namely the pragmatists and the hardliners. The table below reflects which members of the Bush administration were in these factions.

Figure 5.4
Bush Administration Factions

Hardliners	Pragmatists	
George Bush (E) Dick Cheney (E) Donald Rumsfeld (E) Robert Joseph (E) Stephen Yates (E) Aaron Friedberg (E) Lewis Libby (E) Victor Cha (E) John Rood (E) Stuart Levey (T) Daniel Glaser (T) Jay Lefkowitz (S) Alexander Vershbow (S) Richard Armitage (S) Paula Dobriansky (S) Condoleezza Rice (S) John Bolton (S) David Asher (S)	Christopher Hill (S) Michael Green (E) Sung Kim (S) Robert Zoellick (S) James Foster (S)	E - Executive T - Treasury Department S - State Department

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It is clear that there were divisions within the administration over the policy towards North Korea. In the left column, the influential ‘hardliner’ coalition that

¹⁹⁷ Table 5.5 compiled by Sean M. Blakeley. Important to note: Mike Chinoy’s *Meltdown*, Leon Sigal’s *Failed Diplomacy* were used to determine these statuses. Hardliner meaning adopted ideological, non-negotiation posture to North Korea. Pragmatist meaning less ideologically driven and open to negotiation with North Korea. Hardliner/Pragmatist are considered a mixture of both elements.

consists of Secretary of Defense Rumsfeld and his advisers, Vice President Cheney and his advisers, members of the Treasury and proliferation experts in the State Department and White House led by Under Secretary of State, John Bolton. This group opposed negotiations with North Korea, favored the issuance of demands for unilateral North Korean concessions on military issues, and advocated isolating North Korea diplomatically and through economic sanctions in order to cause regime change. This faction expressed the hope and/or expectations of a collapse of the North Korean regime and consisted of eighteen high-ranking policy-makers, including the President himself. The second group, which is in the right column, was made up of officials in the State Department and White House with experience on East Asian and Korean issues, and they favored negotiations before adopting more coercive sanctions; they doubted the effectiveness of a coercive strategy to bring about a North Korean collapse.¹⁹⁸ Negotiations and coercion were the polarized default policy positions of these two factions.

The table also shows that while the pragmatists were based in the State Department, the executive agencies were almost exclusively staffed by hardliners and so it would be reasonable to expect that the hardliners were able to influence policy to a greater extent. In the case of the BDA sanction, it is evident that this sanction taken by the Treasury Department and approved by the Executive, would not have passed through the State Department, and thus may not have been seen by pragmatists, instead only viewed and approved by hardliners. Whether deliberately or coincidently this administrative division and decision-making process may have prevented policy cohesion. Departmental commonality was actually missing. Their contradiction and imbalance exacerbated divisions and prevented a forging of a common interest within

¹⁹⁸ Larry A. Niksch, *Korea-US Relations: Issues for Congress*, p. 21.

the administration and the making of an appropriate scope for the policy. Counterfactually, a more balanced distribution of hardliners and pragmatists may have provided a less divisive policy and stopped the BDA's objective from becoming one of deliberately destabilising North Korea, as pragmatists, more willing to resolve the problems caused by the sanction, would have held more influence. The State Department having conducted a policy of engagement that was proportional in and of itself, however, was forced to work within a coercive strategy, when augmented and altered by the introduction of the BDA. The switch from pragmatist-led to hardliner-led and from engagement-based to coercive-based caused the US-DPRK to be disproportional.

When looking at their objectives, the hardliners who implemented the BDA, sought to coerce the North to give up its weapons, whereas pragmatists and figures such as Rice and Cha, looked to engage the North on this issue. Departmentally, the State Department was isolated in striving for engagement and stood in opposition to the Executive, Treasury and elements of their own department. The hardliners who drove the BDA policy and many of their default political positions on the DPRK was the coercion or isolation of the regime. With regards to the BDA policy itself, the actual 'demand' or 'scope' needed to be proportional to what North Korea expected to gain by compliance, but it was not. Had the demand remained isolated to financial punishment and the policy, it may have been able to be overcome or rescinded as it succeeded in financially hurting the North. However, its maintenance and use as a coercive tool made this impossible. Ultimately, the demand made on North Korea meant it was being made to concede more for the same reward. Done in the wake of the signing of the 9.19 agreement, the North felt that this made the deal disproportional.

Contrasting objectives, divergent default political positions and factious grouping meant that the BDA was introduced to a policy that was made disproportional by its presence. The original State Department-led engagement policy was forcibly changed by hardliners to be coercive, and the disproportionally caused by the broadening of its objective. The division on personal and departmental levels on the policy goal exacerbated the problem as hardliners broadened its scope to that of a coercive tool and in doing so made the coercive calculus for North Korea unacceptable. As hardliners wanted, the BDA did pressure North Korea, but it was so disproportional that the ‘squeeze’ caused them to reject ‘talking’. However, wanting to coerce rather than engage, hardliners were unwilling to drop the sanction, as pragmatists wanted, until it clearly failed.

5.5.2 Reciprocity

As well as proportionality, reciprocity involves an explicit or at least mutually tacit understanding of linkage between the coercer’s carrots and the target’s concessions. Whether incremental or not, mutual confidence must exist between the two states in order for one to trust the other to reciprocate in terms of making concessions or enforcing threats. Jentleson notes that an incremental approach can establish this reciprocity. Timing and the ability to react to indicators determine whether this reciprocal confidence can be made.

When judging the timing of the BDA and the reaction of the US to the DPRK ‘indicators’, it is important to look at the series of events that surrounded its implementation. Prior to the BDA, relations between the US and the DPRK cannot be

said to have been trustful or positive. The DPRK had called on the US to end its 'hostile policy', had stalled Six-Party Talks, announced progress on building a nuclear weapon and fired a missile. The US regularly labelled the DPRK 'evil' and a 'rogue state', insisted upon CVDI and indirectly threatened Pyongyang with regime change.

However, despite this strained relationship all the members of the Six-Party Talks signed the 9.19 Agreement and a warming of US-DPRK relations is evidenced. This progress was negated by the fact that within hours of the agreement, BDA announced the closure of its services to North Korea and the affair began to intensify until North Korea linked the sanction to the denuclearization issue and made its withdrawal a prerequisite of returning to Six-Party Talks. This was a clear indicator to which the US ought to have reacted. North Korea, believing it had negotiated a balanced settlement for progress through the 9.19 Joint Agreement, felt that its concession had been met with further demands. The DPRK did not view this as a reciprocal move. Not seen as independent of this deal, the BDA timing was reckless and destabilizing to North Korea, as it reduced their motivation to engage with the US and prompted their stalling of talks. Refusal to allow Christopher Hill to visit Pyongyang, unwilling to grant bilateral talks on the matter and an incremental hardening of policy in the face of DPRK complaints about the BDA simply acted to confirm North Korean suspicions that the US was not interested in a reciprocal relationship.

The timing and severity of the sanction and its potential to alter the coercive balance of the US policy was realized by elements of the State Department and reflected in their actions. For example, despite ultimately being rejected by hardliners, requests were made by Hill to set up a briefing session for North Koreans following

the implementation of the BDA sanction. Also, at various times Hill was even said to be 'furious about the timing of the sanction' and 'bloodcurdling' on the wording of the unilateral statement. As well as this, he expressed doubt over the legitimacy of the BDA sanction and described the action of hardliners at various times as 'petty,' 'blackmail,' and 'rude.' Although Hill noted that he 'has to do this' in reference to the sanction, he was quick to detach himself from the policy and ultimately by mid September 2006 devised a secret plan to end the sanction. This was because he felt that moves to limit the actions of pragmatists were continuing as the 'neo-cons seized on BDA' and 'stuck on it.' Hill recognized the ill timing of the sanction and the neo-con seizure of it with regards to its objectives. The more the hardliners 'stuck on it' and refused to accept DPRK indicators that showed reciprocity was missing, the more threatening North Korea became.

In stages three to five we see that the hardliners in the Bush administration continue to support the sanction and refuse to accept North Korean complaints. Attempts to claim that the BDA sanction was an isolated issue from that of denuclearization failed, as North Korea did not separate the respective policies. It was not until North Korea exploded its first nuclear weapon the US position changed and the DPRK's indicator heeded. Once BDA was withdrawn and reciprocity reestablished by the fact that the US had shown an ability to react to the target nations' indicator, and then the February Agreement could be signed. The ill-timed implementation and the US's unwillingness to react to DPRK indicators led to a break down in reciprocity between the two states.

Chapter VI

Conclusion & Implications of the BDA Affair

6.1 Conclusion

The analysis of this paper shows that the BDA was actually a sanction that failed to achieve the three basic parameters of coercer strategy that are necessary to achieve coercive diplomacy. Proportionality was imbalanced as the internal US hardliner factions broadened the BDA's objective to a scope that the means could simply not achieve. Reciprocity was not established as its implementation came at a time of reciprocal vulnerability. US refusal to recognise DPRK indicators that it considered the US to have broken reciprocity and prevented the necessary incremental confidence from developing. Furthermore, though their manner of supporting the BDA is not identical, the US could not effectively find the common interest and reasonable objectiveness to match their superior strength and convince South Korea and China to support the BDA. Though China found greater common interest in the sanction and perceived it to have a reasonable objective for longer than South Korea did, support gradually weakened to the point of withdrawal in both countries.

Internationally, the BDA issue actually divided the common interest that had existed between the three allies. The longer the issue lasted and the more that the Bush administration continued to pursue the policy, the more divided this interest became and the less supportive Seoul and Beijing became. Ultimately their roles transformed from one of 'quiet support' to one of a 'disruptive' nature. Without a common interest to bind the allies, support for the sanction and thus its coercive credibility crumbled. Similarly, labeled as 'inconclusive', a 'hurdle' an 'obstacle', and 'regrettable', the perception of the BDA sanction as inappropriate, sabotaging and

or incompetent, meant that it was not perceived to have a 'reasonable objective', particularly after North Korea had linked it to the denuclearization issue and acted threateningly in response to it. Without this necessary perception, support for the sanction from South Korea and China and thus coercive credibility was never fully established. It was not until after the first nuclear test by North Korea that these divergent parameters converged to create the mutual objective of ending the BDA sanction and re-aligning 'common interest' as Six-Party Talks were restarted and the February Agreement signed.

Domestically, the BDA's initial objective was both limited and successful until it was linked to denuclearization by the DPRK and subsequently used by US hardliners and attributed to an unachievable broader objective of destabilizing the DPRK with a view creating leverage to pressure the DPRK regime. Though it created pressure, the lack of coercive proportionality and reciprocity meant it was not able to be successful. In fact, the longer the issue lasted and the more that the Bush administration continued to pursue the BDA sanction, the more this objective angered North Korea as it turned an engagement policy into one of coercion. Ultimately proportionality was lost and the sanction was withdrawn as the scope of the measure went beyond that of financial punishment and became an obvious attempt to pressure and gain leverage over the Kim Jong il regime. Likewise, the ill-timing of the BDA and the US's unwillingness to act upon DPRK indicators of discontent over being seemingly punished during a period of supposed agreement meant that reciprocity could not be established. Reciprocity was not re-established until the BDA sanction was withdrawn.

Thus, looked at more broadly, there were just two occasions when the BDA brought a coordinated and united response from the US and its allies. These were: (1)

Hardliner control of policy in Washington + Chinese support + South Korean support + BDA limited objective and (2) Pragmatist control of policy in Washington + Chinese support + South Korean support + BDA withdrawal. It was therefore not the type of political faction in charge in Washington, or the sanction itself that negated its use, but rather the objective which it was seen to have. It was the South Korean and Chinese lack of support that caused the withdrawal, but this was due to a change in objectives caused by internal factions in US politics that imbalanced proportionality and did not create the necessary reciprocal relationship with the DPRK. Allies had supported the sanction when limited in scope and reciprocally not linked to denuclearization, but once hardliners began to use the BDA to destabilize North Korea, with the aim to coercively pressure the Kim regime, this support was lost.

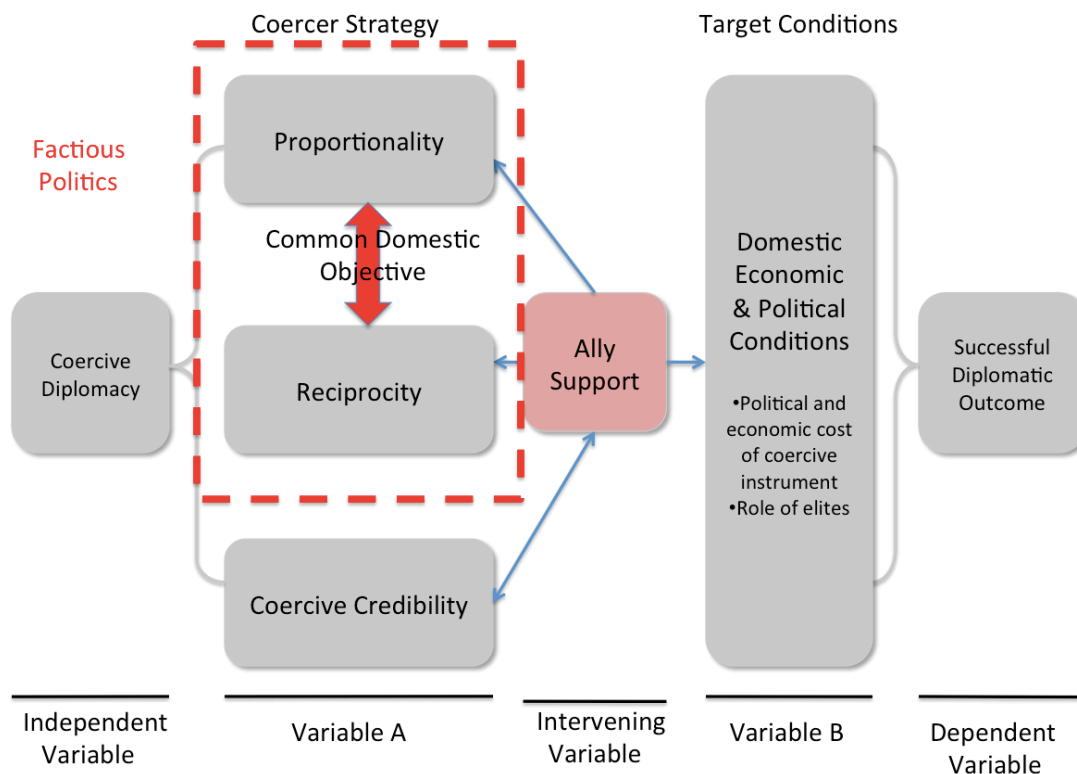
When the policy goal was limited, support had allowed the BDA – through active South Korean implementation of the sanction and Chinese investigations into illicit activities, to be a success in terms of its financial objectives. However, when adapted into a coercive policy tool to pressure North Korea and create leverage for the US, thus unbalancing proportionality and unsettling the reciprocity that had been created after the signing of the 9.19 Agreement, it could not be effective as a tool of coercive diplomacy and was ultimately withdrawn. Therefore, it is clear that though the hypotheses presented in this paper can all be said to be valid and are complementary in nature, the most significant reason why the BDA failed was its broadened change in objective and the effect that the loss of proportionality and reciprocity had on the US relations with the DPRK, ROK and PRC.

6.2 Implications of the BDA Affair

This paper reveals the two important aspects of coercive diplomacy that have been neglected. Firstly, that bridging domestic political division with regards to the implementation of a sanction in order to unify policymakers is essential and secondly, that the influence of allied cooperation actually lies beyond just the establishing of coercive credibility parameter and actually influences proportionality and reciprocity as well. Therefore, the formation of Jentleson's framework would be better reflected in the below diagram which indicates the greater significance of the role of unified policymakers and that of allied cooperation.

Figures 6.1

Jentleson's Amended Framework



Existing literature related to sanctions including that of Bruce Jentleson, point out that in order for coercive diplomacy to work there must be limited opposition to sanctions used in such institutional bodies like the US Congress. However, in the case of the BDA, it is not opposition to sanctions that caused a lack of proportionality or reciprocity, it was internal political factions with divergent policy objectives that effectively nullified the effect of the BDA. The lack of a unified policy caused by these divisions determined the failure of the sanction. This is a variable that Jentleson and others neglected to mention and would supplement his theoretical framework. A consistently limited goal achieved by a unified position of the part of factious elements of the US government would have aided proportionality and a greater awareness of the incremental steps needed to instill confidence into a coercive relationship that would have established reciprocity.

Secondly, Jentleson suggests that cooperation from allies is a method by which coercive credibility can be achieved. However, this paper asserts that the influence of allied cooperation actually lies beyond this one parameter and influences proportionality and reciprocity as well. For example, in the BDA case, the US chose to ignore calls from both China and South Korea to limit the objectives of the sanction, hold bilateral talks on its resolution and withdraw it earlier. However, had they done so then the proportionality of the sanction may have been reduced and thus made more achievable and reciprocity may have been enhanced by US reaction to

¹⁹⁹ Figure 2.3 was made by S. Blakeley and is based upon the theoretical framework of Bruce Jentleson as outlined in Bruce Jentleson and Christopher A. Whytock, *Who “Won” Libya? The Force-Diplomacy Debate and Its Implications for Theory and Policy*. The blocks in blue, ‘no variance’ and in red, ‘US policy objective & coordination’ and ‘China & South Korea support’ are the indicators that this paper uses in order to measure the variables extracted from Jentleson’s framework. The implications of the paper entitled ‘Financial Sanctions Against North Korea: Explaining the Failure of the Banco Delta Asia Sanction’, by Sean Blakeley, were applied to this diagram.

indicators from states which had enjoyed a friendlier relationship with the DPRK at this time. Thus, the role of allied cooperation is not simply limited to the attainment of credibility but more broadly related to all aspects of coercer strategy. Further research into alternative cases where factious politics may have acted as an intervening variable and the broader influence of allied support in coercive diplomacy would be of benefit in expanding this area of study.

It is clear that the BDA sanction, as a new 'reputational sanction' was very successful in terms of the financial damage it was able to cause to North Korea. When its objectives were limited in scope, then it was very effective. However, this paper reflects the fact that such sanctions are not in fact isolated measures and do need to work as part of a broader coercive diplomatic strategy. In terms of this, the scope of its objective, the timing of its implementation and the reactions of allies in the region must be considered in order for it to have success as a coercive tool.

With regards to the implications on the effect of sanctions in international politics, it is evident that the reputational sanctions do constitute an interesting and important fifth group of study. This study indicates that they appear to have some degree of effect on the target state and show that the reputational concerns of non-political entities, in this case banks, can affect states. Though this case alone cannot claim to show that such sanctions change state behavior, it does show that they are able to cause significant pain to them. It should be noted that their implementation is limited by the fact that they can only be used against state conducting illicit activities, may complicated other diplomatic approaches and if used too frequently may be detrimental to the economy of the actor who uses it. However, if used for a specific goal that is agreed upon by policymakers and allies alike, reputational sanctions, as part of broader coercive diplomacy, can be a very effective tool. With this in mind,

the role of the private sector in determining the success of international security policies is one that needs to be explored further.

The implications of my paper's finding therefore go beyond US policy towards North Korea and the BDA. This paper however, shows that the question of whether reputational sanctions should be used as an end in itself or as a part of a broader political strategy needs to be investigated more fully. Though these sanctions are effective ways to punish financial ill practice, it is evident that states may at some point withdraw such a sanction due to national security interests. Further implementation of such reputational sanctions will require a clear conviction of its intended objectives: financial punishment or political coercion. If a clear objective is set and maintained when such a sanction is implemented, then this tool could provide the international community with a very effective way to deter the activity of rogue states. The role of reputational sanctions and their ability to use the influence of the private sector has the potential to be a new tool of coercive diplomacy in such areas as international financial crime, the funding of terrorism and other crime, and help to alter long-term state behavior.

Appendix

55214 Federal Register/Vol. 70, No. 181/Tuesday, September 20, 2005/Notices

Tuesday, September 20, 2005

Part II

Department of the Treasury

31 CFR Part 103

Finding That Banco Delta Asia SARL Is a Financial Institution of Primary Money Laundering Concern; Notice Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations—Imposition of Special Measure Against Banco Delta Asia SARL; Proposed Rule

DEPARTMENT OF THE TREASURY

Finding That Banco Delta Asia SARL Is a Financial Institution of Primary Money Laundering Concern

AGENCY: The Financial Crimes Enforcement Network, Treasury.

ACTION: Notice of finding.

SUMMARY: Pursuant to the authority contained in 31 U.S.C. 5318A, the Secretary of the Treasury, through his delegate, the Director of the Financial Crimes Enforcement Network, finds that reasonable grounds exist for concluding that Banco Delta Asia SARL (Banco Delta Asia) is a financial institution of primary money laundering concern.

DATES: The finding made in this notice is effective as of September 20, 2005.

FOR FURTHER INFORMATION CONTACT: Regulatory Policy and Programs Division, the Financial Crimes Enforcement Network, (800) 949-2732.

SUPPLEMENTARY INFORMATION:

I. Background

A. Statutory Provisions

On October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the USA PATRIOT Act), Public Law 107-56. Title III of the USA PATRIOT Act amends the anti-money laundering provisions of the Bank Secrecy Act (BSA), codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959, and 31 U.S.C. 5311-5314, 5316-5332, to promote the prevention, detection, and prosecution of international money laundering and the financing of terrorism. Regulations implementing the BSA appear at 31 CFR part 103. Section 311 of the USA PATRIOT Act ("section 311") added section 5318A to the BSA, granting the Secretary of the Treasury (the "Secretary") the authority, upon finding that reasonable grounds exist for concluding that a foreign jurisdiction, institution, class of transactions, or type of

account is of “primary money laundering concern,” to require domestic financial institutions and financial agencies to take certain “special measures” against the primary money laundering concern. Section 311 identifies factors for the Secretary to consider and Federal agencies to consult before the Secretary may conclude that a jurisdiction, institution, class of transaction, or type of account is of primary money laundering concern. The statute also provides similar procedures, i.e., factors and consultation requirements, for selecting the specific special measures to be imposed against the primary money laundering concern. For purposes of the finding contained in this notice, the Secretary has delegated his authority under section 311 to the Director of the Financial Crimes Enforcement Network.¹ Taken as a whole, section 311 provides the Secretary with a range of options that can be adapted to target specific money laundering and terrorist financing concerns most effectively. These options give the Secretary the authority to bring additional pressure on those jurisdictions and institutions that pose money-laundering threats. Through the imposition of various special measures, the Secretary can gain more information about the jurisdictions, institutions, transactions, or accounts of concern; can more effectively monitor the respective jurisdictions, institutions, transactions, or accounts; or can protect US financial institutions from involvement with jurisdictions, institutions, transactions, or accounts that pose a money laundering concern. Before making a finding that reasonable grounds exist for concluding that a foreign financial institution is of primary money laundering concern, the Secretary is required to consult with the both the Secretary of State and the Attorney General. The Secretary is also required by section 311 to consider “such information as the Secretary determines to be relevant, including the following potentially relevant factors”:

- The extent to which such financial institution is used to facilitate or promote money laundering in or through the jurisdiction;
- The extent to which such financial institution is used for legitimate business purposes in the jurisdiction; and
- The extent to which the finding that the institution is of primary money laundering concern is sufficient to ensure, with respect to transactions involving the institution operating in the jurisdiction, that the purposes of the BSA continues to be fulfilled, and to guard against international money laundering and other financial crimes.

If the Secretary determines that reasonable grounds exist for concluding that a foreign financial institution is of primary money laundering concern, the Secretary must determine the appropriate special measure(s) to address the specific money laundering risks. Section 311 provides a range of special measures that can be imposed individually, jointly, in any combination, and in any sequence.² The Secretary’s imposition of special measures requires additional consultations to be made and factors to be considered. The statute requires the Secretary to consult with appropriate federal agencies and other interested parties³ and to consider the following specific factors:

- whether similar action has been or is being taken by other nations or multilateral groups;
- Whether the imposition of any particular special measures would create a significant competitive disadvantage, including any undue cost or burden associated with compliance, for financial institutions organized or licensed in the United States;
- The extent to which the action or the timing of the action would have a significant adverse systemic impact on the international payment, clearance, and settlement system, or on legitimate business activities involving the particular institution; and
- The effect of the action on the United States national security and foreign policy.⁴

B. Banco Delta Asia

Banco Delta Asia, located and licensed in the Macau Special Administrative Region, China, is the commercial banking arm of its parent company, Delta Asia Group (Holdings) Ltd. (Delta Asia Group).⁵ In addition to commercial banking, Delta Asia Group engages in investment banking and insurance activities. Banco Delta Asia was originally established in 1935 as Banco Hang Sang,⁶ and its name changed to Banco Delta Asia in December 1993. With approximately 340 employees and a total equity of approximately \$35 million at the close of 2003, Banco Delta Asia is the fourth smallest commercial bank in Macau. Banco Delta Asia operates eight branches in Macau (including a branch at a casino) and is served by a representative office in Japan. In addition, Banco Delta Asia maintains correspondent accounts in Europe, Asia, Australia, Canada, and the United States, and has two wholly owned subsidiaries: Delta Asia Credit Ltd., and Delta Asia Insurance Limited.⁷

C. Macau Money laundering has been identified as a significant problem in the Macau Special Administrative Region, China.⁸ According to the International Narcotics Strategy Control Report (INSCR) published in March 2005 by the US Department of State, Macau's lack of adequate controls and regulatory oversight of the banking and gaming industries (many of which are associated with organized criminal activity) has led to an environment that can be exploited by money launderers. Moreover, the March 2005 INCSR designates Macau as a "jurisdiction of primary concern."⁹ The International Monetary Fund (IMF) conducted a study in 2002 concluding that, despite its anti-money laundering legal framework, Macau was "materially non-compliant" in terms of monitoring and reporting of suspicious financial transactions.¹⁰ Of special concern is Macau's lack of cross-border currency reporting requirements. In 2003, Macau prepared money-laundering legislation that sought to incorporate the Financial Action Task Force's revised Forty Recommendations on Money Laundering, and to establish a Financial Intelligence Unit. Such legislation has not been adopted and the Financial Intelligence Unit has not been established. As noted in a 2004 IMF study, significant vulnerabilities remain in Macau, although it has made progress in its anti-money laundering regime in the past several years, including the establishment of a Fraud Investigation Section to examine suspicious transactions reports filed by financial institutions. Government agencies and front companies of the Democratic People's Republic of Korea (DPRK or North Korea) that are engaged in illicit activities use Macau as a base of operations for money laundering and other illegal activities. For example, banks in Macau have allowed these organizations to launder counterfeit currency and the proceeds from government-sponsored illegal drug transactions.

D. North Korea The involvement of North Korean government agencies and front companies in a wide variety of illegal activities, including drug trafficking and counterfeiting of goods and currency, has been widely reported.¹¹ Earnings from criminal activity, by their clandestine nature, are difficult to quantify, but studies estimate that proceeds from these activities amount to roughly \$500 million annually.¹² Customs and police officials of many countries have regularly apprehended North Korean diplomats or quasi-official representatives of state trading companies trying to smuggle narcotics. For example, in December 2004, Turkish officials arrested two North Korean diplomats in Turkey in possession of illegal drugs valued at \$7 million. Earlier that year, Egyptian authorities expelled two other North Korean diplomats who attempted to deliver a shipment of controlled substances valued at \$150,000 in Egypt.¹³ In fact, since 1990, North Korea has been positively

linked to nearly 50 drug seizures in 20 different countries, a significant number of which involved the arrest or detention of North Korean diplomats or officials.¹⁴ Proceeds from narcotics trafficking may amount to between \$100 million and \$200 million annually.¹⁵ During the past three decades, there also have been many incidents and arrests involving North Korean officials for distributing supernotes. Since first detected, the United States has taken possession of more than \$45 million of these highly deceptive counterfeit notes. Substantial evidence exists that North Korean governmental entities and officials launder the proceeds of narcotics trafficking, counterfeit activities, and other illegal activities through a network of front companies that use financial institutions in Macau for their operations.

II. Analysis of Factors

Based upon a review and analysis of relevant information, consultations with relevant Federal agencies and departments, and after consideration of the factors enumerated in section 311, the Secretary has determined that reasonable grounds exist for concluding that Banco Delta Asia is a financial institution of primary money laundering concern. A discussion of the section 311 factors relevant to this finding follows: 1. The Extent to Which Banco Delta Asia Has Been Used To Facilitate or Promote Money Laundering in or Through the Jurisdiction The Secretary has determined, based upon a variety of sources, that Banco Delta Asia is used to facilitate or promote money laundering and other financial crimes. Banco Delta Asia has provided financial services for over 20 years to multiple North Korean government agencies and front companies that are engaged in illicit activities, and continues to develop these relationships. In fact, such account holders comprise a significant amount of Banco Delta Asia's business. Banco Delta Asia has tailored its services to the DPRK's demands. For example, sources show that the DPRK pays a fee to Banco Delta Asia for financial access to the banking system with little oversight or control. The bank also handles the bulk of the DPRK's precious metal sales, and helps North Korean agents conduct surreptitious, multi-million dollar cash deposits and withdrawals. Banco Delta Asia's questionable relationship with the DPRK is further demonstrated by its maintenance of an uninterrupted banking relationship with one North Korean front company despite the fact that the head of the company was charged with attempting to deposit large sums of counterfeit currency into Banco Delta Asia and was expelled from Macau. Although this same person later returned to his previous leadership position at the front company, services provided by Banco Delta Asia were not discontinued.

Banco Delta Asia's special relationship with the DPRK has specifically facilitated the criminal activities of North Korean government agencies and front companies. For example, sources show that senior officials in Banco Delta Asia are working with DPRK officials to accept large deposits of cash, including counterfeit US currency, and agreeing to place that currency into circulation. Additionally, it has been widely reported that one well-known North Korean front company that has been a client of Banco Delta Asia for over a decade has conducted numerous illegal activities, including distributing counterfeit currency and smuggling counterfeit tobacco products. In addition, the front company has also long been suspected of being involved in international drug trafficking.

Moreover, Banco Delta Asia facilitated several multi-million dollar wire transfers connected with alleged criminal activity on behalf of another North Korean front

company. In addition to facilitating illicit activities of the DPRK, investigations have revealed that Banco Delta Asia serviced a multi-million dollar account on behalf of a known international drug trafficker.

2. The Extent to Which Banco Delta Asia Is Used for Legitimate Business Purposes in the Jurisdiction It is difficult to determine the extent to which Banco Delta Asia is used for legitimate purposes. Most banking transactions within Macau are conducted by the jurisdiction's largest banks, while Banco Delta Asia ranks as one of the smallest in Macau. Although Banco Delta Asia likely engages in some legitimate activity, the Secretary believes that any legitimate use of Banco Delta Asia is significantly outweighed by its use to promote or facilitate money laundering and other financial crimes.

3. The Extent to Which Such Action Is Sufficient To Ensure, With Respect to Transactions Involving Banco Delta Asia, That the Purposes of the BSA Continue To Be Fulfilled, and To Guard Against International Money Laundering and Other Financial Crimes As detailed above, the Secretary has reasonable grounds to conclude that Banco Delta Asia is being used to promote or facilitate international money laundering, and is therefore an institution of primary money laundering concern. Currently, there are no protective measures that specifically target Banco Delta Asia. Thus, finding Banco Delta Asia to be a financial institution of primary money laundering concern, which would allow consideration by the Secretary of special measures to be imposed on the institution under section 311, is a necessary first step to prevent Banco Delta Asia from facilitating money laundering or other financial crime through the US financial system. The finding of primary money laundering concern will bring criminal conduct occurring at or through Banco Delta Asia to the attention of the international financial community and, it is hoped, further limit the bank's ability to be used for money laundering or for other criminal purposes.

III. Finding

Based on the foregoing factors, the Secretary, acting through the Director of the Financial Crimes Enforcement Network, hereby finds that Banco Delta Asia is a financial institution of primary money laundering concern.

Dated: September 12, 2005.

William F. Baity,

Deputy Director, Financial Crimes
Enforcement Network.

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BILLING CODE 4810-02-P

1 Therefore, references to the authority and findings of the Secretary in this document apply equally to the Director of the Financial Crimes Enforcement Network.

2 Available special measures include requiring: (1) Recordkeeping and reporting of certain financial transactions; (2) collection of information relating to beneficial ownership; (3) collection of information relating to certain payable-through accounts; (4) collection of information relating to certain correspondent accounts; and (5) prohibition or conditions on the opening or maintaining of correspondent or payable-through accounts. 31 U.S.C. 5318A(b)(1)-(5). For a complete discussion of the range of possible countermeasures, see 68 FR 18917 (April 17, 2003) (proposing special measures against Nauru).

3 Section 5318A(a)(4)(A) requires the Secretary to consult with the Chairman of the Board of Governors of the Federal Reserve System, any other appropriate Federal banking agency, the Secretary of State, the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), the National Credit Union Administration (NCUA), and, in the sole discretion of the Secretary, “such other agencies and interested parties as the Secretary may find to be appropriate.” The consultation process must also include the Attorney General, if the Secretary is considering prohibiting or imposing conditions on domestic financial institutions opening or maintaining correspondent account relationships with the designated entity.

4 Classified information used in support of a section 311 finding and measure(s) may be submitted by Treasury to a reviewing court *ex parte* and *in camera*. See section 376 of the Intelligence Authorization Act for fiscal year 2004, Pub. L. 108– 177 (amending 31 U.S.C. 5318A by adding new paragraph (f)).

5 The Bankers Almanac (2004). This finding of primary money laundering concern shall apply exclusively to Banco Delta Asia and its branches, offices, and subsidiaries, and not to Delta Asia Group (Holdings) Ltd., or any of its other subsidiaries.

6 Banco Delta Asia’s historical name, Banco Hang Sang, is not to be confused with Hang Seng Bank, a Hong Kong bank, nor the Hang Seng Index, an index of certain shares traded on the Hong Kong Stock Exchange.

7 The Banker’s Almanac (2004).

8 References in this rule to the money laundering risks in Macau are limited to that jurisdiction, and not applicable to the entire jurisdiction of China.

9 “Jurisdictions of primary concern” are jurisdictions that are identified as “major money laundering countries,” that is, countries “whose financial institutions engage in currency transactions involving significant amounts of proceeds from international narcotics-trafficking.”

See, <http://www.state.gov/g/inl/rls/nrcrpt/2005/vol2/html/42388.htm>.

10 See International Monetary Fund, Monetary and Exchange Affairs Department, Macau SAR 2002

http://www.amcm.gov.mo/Press_Release/IMF/

11 Emergency Responses and Research Institute: “North Korea Government Deeply Involved With Organized Crime?” June 30, 1998; BBC News: “What is a Superdollar?” June 20, 2004; Washington Post: “North Korea’s Conduit for Crime”, April 25, 1999; Pacific Forum CSIS: “End North Korea’s Drug Trade”, June 16, 2003.

12 Congressional Research Service Report for Congress: “Drug Trafficking and North Korea: Issues for US Policy”, Updated March 4, 2005.

13 See INCSR 2005 [pg. 335].

14 Congressional Research Service Report for Congress: “Drug Trafficking and North Korea: Issues for US Policy,” Updated March 4, 2005.

15 *Id.*

October 21, 2005JS-2984

TREASURY TARGETS NORTH KOREAN ENTITIES FOR SUPPORTING WMD PROLIFERATION

The US Department of the Treasury today designated eight North Korean entities pursuant to Executive Order 13382, an authority aimed at freezing the assets of proliferators of weapons of mass destruction (WMD) and their delivery vehicles. Today's action prohibits all transactions between the designated entities and any US person and freezes any assets the entities may have under US jurisdiction.

'Proliferators of WMD often rely on front companies to mask their illicit activities and cover their tracks,' said Stuart Levey, the Treasury's Under Secretary for Terrorism and Financial Intelligence (TFI). 'Today's action turns a spotlight on eight firms involved in WMD proliferation out of North Korea. We will continue to expose and designate these dangerous actors.'

Today's action builds on President Bush's issuance of E.O. 13382 on June 29, 2005. The Order carried with it an annex that designated eight entities 'operating in North Korea, Iran, and Syria' for their support of WMD proliferation. The President at that time also authorized the Secretaries of Treasury and State to designate additional entities and individuals proliferating WMD and the missiles that carry them.

Korea Mining Development Corporation (KOMID), which was designated in the annex of E.O. 13382, is the parent company of two of the Pyongyang-based entities designated today, Hesong Trading Corporation and Tosong Technology Trading Corporation. These direct associations meet the criteria for designation because the entities are owned or controlled by, or act or purport to act for or on behalf of KOMID.

Korea Ryonbong General Corporation, also named in the annex, is the parent company of the remaining six Pyongyang-based entities designated today. These entities include Korea Complex Equipment Import Corporation, Korea International Chemical Joint Venture Company, Korea Kwangsong Trading Corporation, Korea Pugang Trading Corporation, Korea Ryongwang Trading Corporation, and Korea Ryonha Machinery Joint Venture Corporation.

As subsidiaries of KOMID and Korea Ryonbong General Corporation, many of these entities have engaged in proliferation-related transactions.

Identifying Information

HESONG TRADING CORPORATION Pyongyang, North Korea

KOREA COMPLEX EQUIPMENT IMPORT CORPORATION Rakwon-dong, Pothonggang District, Pyongyang, North Korea

KOREA INTERNATIONAL CHEMICAL JOINT VENTURE COMPANY AKA: CHOSON INTERNATIONAL CHEMICALS JOINT OPERATION COMPANY

AKA: CHOSUN INTERNATIONAL CHEMICALS JOINT OPERATION COMPANY AKA: INTERNATIONAL CHEMICAL JOINT VENTURE CORPORATION Hamhung, South Hamgyong Province, North Korea Mangyongdae-kuyok, Pyongyang, North Korea Mangyongdae-gu, Pyongyang, North Korea

KOREA KWANGSONG TRADING CORPORATION Rakwon-dong, Pothonggang District, Pyongyang, North Korea

KOREA PUGANG TRADING CORPORATION Rakwon-dong, Pothonggang District, Pyongyang, North Korea

KOREA RYONGWANG TRADING CORPORATION AKA: KOREA RYENGWANG TRADING CORPORATION Rakwon-dong, Pothonggang District, Pyongyang, North Korea

KOREA RYONHA MACHINERY JOINT VENTURE CORPORATION AKA: CHOSUN YUNHA MACHINERY JOINT OPERATION COMPANY AKA: KOREA RYENHA MACHINERY J/V CORPORATION AKA: RYONHA MACHINERY JOINT VENTURE CORPORATION Central District, Pyongyang, North Korea Mangungdae-gu, Pyongyang, North Korea Mangyongdae District, Pyongyang, North Korea

TOSONG TECHNOLOGY TRADING CORPORATION Pyongyang, North Korea

Recognizing the need for additional tools to combat the proliferation of WMD, President Bush signed Executive Order 13382 authorizing the imposition of strong financial sanctions against not only WMD proliferators, but also entities and individuals providing support or services to proliferators.

The designations announced today are part of the ongoing interagency effort by the United States Government to combat WMD trafficking by blocking the property of entities and individuals that engage in proliferation activities and their support networks.

This Department of Treasury press release may be viewed at: <http://www.treas.gov/press/releases/js2984.htm>

Executive Order 13382 can be viewed at <http://www.treasury.gov/resource-center/sanctions/Programs/Documents/wmd.pdf>

DEPARTMENT OF THE TERSURY FINANCIAL CRIMES ENFORCEMENT
NETWORK

December 13, 2005

Advisory

**GUIDANCE TO FINANCIAL INSTITUTIONS ON THE PROVISION OF
BANKING SERVICES TO NORTH KOREAN GOVERNMENT AGENCIES
AND ASSOCIATED FRONT COMPANIES ENGAGED IN ILLICIT
ACTIVITIES.**

This advisory warns US financial institutions that the US Department of the Treasury has concerns that the Democratic People's Republic of Korea ('North Korea'), acting through government agencies and associated front companies, is engaged in illicit activities and may be seeking banking services elsewhere following the finding of Banco Delta Asia SARL to be a financial institution of 'primary money laundering concern' pursuant to Section 311 of the USA PATRIOT Act. Accordingly, US financial institutions should take reasonable steps to guard against the abuse of their financial services by North Korea, which may be seeking to establish new or exploit existing account relationships for the purpose of conducting illicit activities. This advisory is consistent with the US Department of the Treasury's efforts to ensure that US financial institutions are not used as a conduit for the laundering of proceeds from such illicit activities as currency counterfeiting, narcotics trafficking, counterfeit cigarette smuggling, and the financing of and involvement in weapons of mass destruction and missile proliferation. We encourage financial institutions worldwide to take similar precautions.

The Department of the Treasury is actively monitoring this situation and will take any further action as appropriate. We will provide updated information to the financial industry as warranted. Financial institutions with questions about this advisory may contact the Financial Crimes Enforcement Network's regulatory helpline at 1-800-949-2732.

Background

Section 311 of the USA PATRIOT Act added Section 5318A to the Bank Secrecy Act, authorizing the Secretary of the Treasury to find a foreign financial institution, jurisdiction, class of transactions or type of account to be of 'primary money laundering concern.' Upon such finding and following a rulemaking process, the Secretary is authorized to take additional steps to further protect the US financial system by requiring US financial institutions to take certain 'special measures' with respect to the specified entity. Such 'special measures' can include requiring US financial institutions to terminate all correspondent account relationships with the specified entity. In addition to protecting the US financial system, Section 311 findings serve as a notice to the global financial community that a particular institution presents a serious money laundering and illicit financing risk.

As published in the Federal Register on September 20, 2005, we found Banco Delta Asia SARL ('Banco Delta Asia'), which is headquartered in the Macau Special

Administrative Region of China, to be a financial institution of ‘primary money laundering concern.’ As stated in this Federal Register notice, Banco Delta Asia provided financial services for over 20 years to North Korean government agencies and associated front companies that are known to have engaged in illicit activities. North Korean entities are known to have engaged in currency counterfeiting, narcotics trafficking, the production and dissemination of counterfeit cigarettes, and the laundering of related proceeds, as well as weapons of mass destruction and missile proliferation.

Investigations have also revealed that, among other things, Banco Delta Asia has serviced a multi-million dollar account on behalf of a known international drug trafficker. This finding and the accompanying proposal to prohibit US financial institutions from maintaining correspondent accounts for or on behalf of Banco Delta Asia are aimed at protecting the US financial system from ongoing illicit activity facilitated by Banco Delta Asia.

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국문개요

대(對)북한 금융제재: 방코델타아시아 제재의 실패 원인

2005년 9월 15일, 미국 재무부는 마카오의 소규모 은행인 방코델타아시아은행(滙業銀行, Banco Delta Asia)을 주요 자금세탁 우려 대상으로 지목하며, 미국 금융기관들의 북한에 의해 악용되지 않도록 보호할 것을 경고했다. 소위 '평판에 의한 제재(reputational sanction)'라는 이러한 제재의 결과로 마카오 정부는 미화 2500만 달러에 해당하는 북한 자산을 동결했고, 20여 개국의 기관들도 북한에 대한 금융 서비스를 거부하는 조치를 취했다. 미국은 해당 제재가 국제범죄와 관련된 사안이지 비핵화와는 관련이 없다고 주장했으나, 북한은 그것을 6자회담과 연계시키며 북핵 프로그램을 종결시키기 위한 협상의 진전을 막았다.

방코델타아시아에 대한 미국의 제재는 초기에 대내적 • 대외적으로 지지를 받았고, 북한의 불법적 이윤 창출 네트워크의 금융 능력에 심각한 손상을 가하면서 성공을 거둔 것으로 보였다. 그러나 이 제재는 북한과 비핵화에 관해 대화하면서 북한을 금융적으로 압박하려는 "매파 강경(hawk coercion)" 정책 중 하나로 채택되며, 신속히 광범위한 전략의 일부로 바뀌었다. 이러한 강경 외교는 완전히 실패했고, 북한의 미사일 발사와 핵실험이 발생한 후에 미국은 제재를 철회했다.

이 논문은 상품시장의 신뢰를 평가절하했던 이같은 제재의 실패 원인을 강경외교 틀로 분석한다. 브루스 젠틀슨(Bruce Jentleson)의 강경외교 분석틀을 방코델타아시아 제재 사례에 적용함으로써, 해당 제재의 초기 정책에 비례성, 상호성, 강제 신뢰성이 부족했음을 보여준다. 첫째, 비례성의 측면에서 국제적 범죄에 대한 제재라는 초기의 목적이 강제적 비핵화로 확대되었다. 둘째, 상호성의 측면에서 잘못된 시기를 택하고 신호를 보내는 것을 무시하면서 상호간의 신뢰를 달성할 수 없었다. 셋째, 강제 신뢰성의 측면에서 공통이익과 합리적 목적이 부족했다. 이러한 연구는 국가가 강경 외교정책의 일환으로 평판에 의한 제재를 시행하는 과정에서 동맹의 지지와 국내 정치분파가 수행하는 역할을 보여준다는 점에서 함의를 갖는다.